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THE UNIVERSITY OF ALBERTA

PUBLIC ACCOUNTING IN LETHBRIDGE:  
AN INDUSTRY STUDY



by

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A THESIS

SUBMITTED TO THE FACULTY OF GRADUATE STUDIES AND RESEARCH  
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The undersigned certify that they have read, and recommend to the Faculty of Graduate Studies and Research for acceptance, a thesis entitled "Public Accounting in Lethbridge: An Industry Study" submitted by C. R. Edward Sponchia in partial fulfillment of the requirements for the degree of Master of Business Administration.





## ABSTRACT

The paucity of rigorous economic investigation of the professions has left many of the economic aspects of these occupations unknown. The primary objective of this study is to examine the prevailing market conditions of public accounting in Lethbridge.

The market structure-conduct-performance methodology, which has been employed successfully in a number of studies on manufacturing industries, was used in this study. A two part questionnaire was employed to obtain the necessary data concerning the individual practitioners and the operations of the various public accounting offices in the area.

The methodology proved completely adequate for the investigation of the economic aspects of public accounting; however the questionnaire design created data limitations which prevented the evaluation of certain dimensions of the market performance of public accounting in the Lethbridge area. In general, the market was characterized by a very high degree of seller concentration (i.e. dominated by a few locally-owned Chartered Accountant Firms). Inter-accounting association product differentiation was found to be an important factor in the market whereas intra-association product differentiation is relatively



unimportant. Also the certification by accounting associations was found to be the major barrier to entry into the market but overall the barriers to entry were moderately low.

The examination of the market conduct of firms in the area revealed that the accounting associations provided the main means of facilitating coordination among firms; but the non-disclosure of fee levels permitted firms to act more independently in their pricing policies than they would have otherwise. Also it was found that chartered Accountant firms use income "satisficing" objectives in setting their fee levels whereas other public accountants use profit-maximizing objectives; however the competitive position of other public accountants constrains them to setting competitive level fee rates whereas the "satisficing" objectives of Chartered Accountants does not rule out the possibility that monopolistic profits are being obtained with their fee levels. Another aspect of the industry's market conduct is that the sales-promotion policies of most firms are passive and are quite likely detrimental to the public interest. Finally, Chartered Accountant firms have and use market power in the market fee student services as a means of achieving their income goals.





The analysis of the market performance of public accounting in Lethbridge was constrained by data limitations. However, a tentative conclusion based on theoretical predictions and the data collected indicates that the technical efficiency of the industry is inadequate due to the existence of a substantial number of inefficiently small firms and some excess capacity. No conclusions could be made as to the degree of allocative efficiency in the market or as to the rate of return on human capital provided by the income levels of public accountants; however the methods by which these performance dimensions could be determined in any further studies were presented. In other dimensions of market performance of the Lethbridge market it was ascertained that the size of selling costs are excessively low; that the market's product performance is good; and that Chartered Accountant firms are satisfactorily progressive while other firms are not.



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## TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION .....	1
Defining the Industry	
The Geographical Area of the Study	
The Questionnaire	
Methodology	
PART I. MARKET STRUCTURE .....	16
Chapter I. OWNERSHIP AND CONTROL .....	18
Form of Entity	
Types of Firms	
Accounting Association of Firms	
II. MARKET CONCENTRATION .....	28
Measurement of Market Concentration	
Concentration of Public Accounting	
in Lethbridge	
III. PRODUCT DIFFERENTIATION .....	37
Causes of Differentiation	
Product Differentiation of Public	
Accounting in Lethbridge	
IV. CONDITIONS OF ENTRY .....	47
Certification of Association Members	
Product Differentiation	
Condition of Entry to Public Accounting	
in Lethbridge	
V. BARRIERS TO OUTSIDE COMPETITION .....	61



	<u>Page</u>
PART II. MARKET CONDUCT .....	67
VI. DETERMINATION OF FEE LEVELS .....	69
The Degree of Market Independence	
Mechanisms Facilitating Interdependent	
Coordination	
Coordination and Interdependence of	
Public Accounting in Lethbridge	
The Objectives and Methods of Price	
Calculation	
The Pricing Methods and Objectives of	
Lethbridge Public Accountants	
VII. DETERMINATION OF ADVERTISING AND QUALITY	
OF SERVICE .....	100
Quality of Service	
Advertising	
VIII. MARKET CONDUCT OF FIRMS ACTING AS BUYERS	129
Conduct as Buyers in Lethbridge	
PART III. MARKET PERFORMANCE	140
IX. TECHNICAL EFFICIENCY .....	141
Extent to which Offices are of	
Optimal Scale	
Extent of Chronic Excess Capacity	
Technical Efficiency of Public	
Accounting in Lethbridge	





	<u>Page</u>
X. INCOME LEVELS AND ALLOCATIVE	
EFFICIENCY .....	157
Allocative Efficiency	
Income Levels of Public Accountants	
IX. MARKET PERFORMANCE IN OTHER	
DIMENSIONS .....	171
Size of Selling Costs	
Product Performance	
Progressiveness	
BIBLIOGRAPHY .....	179
APPENDIX 1 .....	185



## LIST OF TABLES

TABLE		<u>Page</u>
2.1	Employment in Public Accounting in Lethbridge .....	31
2.2	Full-time Employees for Office .....	32
2.3	Employment Concentration Ratio of Public Accounting in Lethbridge .....	33
2.4	The Sales Concentration Ratio of Public Accounting in Lethbridge .....	34
3.1	Type of Work Performed .....	42
3.2	Activities of Clients .....	43
3.3	Size of Clients .....	44
3.4	Promotional Expenses .....	44
6.1	The Demand Effect of a 25% Fee Rate Increase	89
6.2	The Demand Effect of a 25% Fee Rate Decrease	90
6.3	Percentage of Fee Set on a 'Time Spent' Basis .....	93
6.4	The Most Important Fee Setting Consideration	94
6.5	Average Hourly Fee Rate of Personnel .....	97
7.1	Formal Education of Public Accountants .....	106
7.2	Extent of Reading of Accounting Journals ...	111
7.3	Participation in Development Programmes ....	111
8.1	Student Educational Level Preference .....	133
8.2	Average Starting Salary for Preferred Student .....	137
8.3	Average Salaries of Students in Different Years of Training as a Percentage of a Newly Qualified Accountants Salary .....	137
9.1	Percentage of Staff Underutilization During Slack Period .....	151
9.2	The Weighted Average of Excess Capacity of the Accounting Associations .....	152



## INTRODUCTION

The rapid postwar growth of the service sector of the economy and the accompanying spiralling costs of these services have caused more and more attention to be focussed on the performance of these industries. Concern with their performance caused the Economic Council of Canada to note that it was indeed an anomaly that, in the main, the service industries were exempt from the Combines Investigation Act<sup>1</sup>, and led them to observe that in their view there is:

"enough evidence pointing to the existence in the service sector of anticompetitive practices detrimental to the public interest to lead to the conclusion that the continued exemption of parts of this sector from competition policy cannot be justified."<sup>2</sup>

Included among the service industries exhibiting rapid postwar growth is public accounting. Yet normally public accounting is also regarded as one of the professions; and, for the most part, the public has been exceedingly reluctant to intervene in any manner in the relationships between these self-employed groups and

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<sup>1</sup>. Economic Council of Canada, Interim Report on Competition Policy, (Ottawa: The Queen's Printer, 1969), p. 133.

<sup>2</sup>. Ibid., p. 147.





their clients. Instead for a long time the public has been satisfied to permit the professions to be self-regulating. It is only in recent years that the rapidly advancing costs of their services and changing social conditions have caused the public to seriously consider having these practices also subjected to some form of social control. Still the question must be asked as to whether or not additional social controls are either necessary or sufficient for better economic performance by the professions. Unfortunately very few studies have been done on the economic aspects of the professions and those that have been done have concentrated on the medical profession. Thus, at the present time, the lack of sufficient data from which to draw even a tentative conclusion makes it impossible to provide a rational answer to the question posed above.

Therefore, this study will have three purposes. First, to gain an understanding of the economic aspects of public accounting in smaller cities of Alberta, this study shall examine the market conditions of public accounting prevailing in Lethbridge. Second, this study will attempt to develop a questionnaire which will be useful in investigating public accounting in greater depth and on a larger scale. Finally, it is hoped that this study will demonstrate the usefulness of the basic analytical approach employed in examining the economic aspects of any profession.





## DEFINING THE INDUSTRY

Although public accounting is a commonly used and generally understood term, many people have different interpretations as to what this term encompasses. In this study "public accounting" refers to the performance of services which includes bookkeeping service, tax consultation, the investigation or audit of accounting records for the purposes of the preparation of or reporting on financial or related statements, and any other related accounting work. The term "market", which is frequently used in this study, may also prove ambiguous. A "market" is generally conceived to be "a closely inter-related group of buyers and sellers."<sup>3</sup> In this study the terms "market" and "industry", as it will be defined, will be used interchangeably.

In the real world, the operational delineation of a "market" or "industry" is extremely complex. The source of this complexity centres around defining "industry boundaries". These boundaries between products, geographical area, and even in time are not clear cut. Statistics Canada uses an elaborate system - the Standard Industrial Classification - for categorizing the output

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<sup>3</sup> Joe S. Bain, Industrial Organization, (2d ed, New York: John Wiley and Sons, Inc., 1968), p. 7.



of every business enterprise.<sup>4</sup> It is organized around a series of four-digit numbers, each successive digit reflecting a finer degree of classification. The industry is a group of firms (or divisions of firms) which either (a) produce similar products, and/or (b) employ similar processes, or (c) use the same chief component, or (d) provide output which performs the same user-function.<sup>5</sup> Unfortunately, the Statistics Canada industry and product classification does not always conform consistently to the criteria economists would like to apply and thus sometimes does not reflect the true competitive relationships. Relative to the economists ideal industry definition, the Statistics Canada industries are frequently over-inclusive, by grouping products which are not in close competition with each other; and, occasionally these industries are under-inclusive. J. S. Bain, the leading authority on industry studies, provides the following definition of the "theoretical industry":

"a group of products that are close substitutes to buyers, and are available to a common group of buyers, and are relatively distant substitutes for all products not included in the industry".<sup>6</sup>

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<sup>4</sup> Government of Canada, Standard Industrial Classification Manual, (Ottawa: Queen's Printer, 1966), p.4.

<sup>5</sup> Ibid., p. 5.

<sup>6</sup> Bain, Op. cit., p. 124.





Thus the economist's ideal industry takes into account substitution in both consumption and production. From the above definition, it can be seen that the criteria for the ideal industry are: (a) close-substitutability of products in both product and consumption, and (b) a common group of buyers.

Thus, to justify the analysis of public accounting in Lethbridge as separate industry or market, an examination must be done to see to what degree it conforms to the ideal industry.

(a) Substitutability of Products: Lethbridge public accountants provide services ranging from relatively simple bookkeeping and write-up work to highly complicated taxation and organizational systems advice. These services are offered by firms ranging in size from the sole practitioner to firms employing a large number of personnel. Yet, although there is a diverse range of services offered by the public accountant, the true nature of his product are the intangible elements of his time, knowledge, and competence. These are really the products which every public accountant offers to all potential clients; although the quality most assuredly does vary among the different practitioners. At the present, the larger firms with their experienced and highly qualified





personnel desire to provide their services mainly to the larger business clients and the more complicated aspects of public accounting, and leave the rest of the market to the smaller and perhaps less highly qualified accounting firms. For the most part, this occurs because it is with these customers that the firm can achieve the largest returns for its skills. However, should the situation arise in which there was a shortage of this type of clientele then the large accounting firms and the more highly qualified public accountant would begin accepting clients whose needs were not as complicated and from whom the public accountant would not be compensated as highly for his skills. Conversely, if the situation should arise in which there was a large excess demand for the type of services now provided by the large firms and the highly qualified public accountants then the potential customers would begin turning to the smaller accounting firms, the less-well-known, and perhaps less qualified public accountants for assistance.

The discussion so far has considered only the substitution possibilities on the production side, but the substitution possibilities on the consumer or demand side must also be examined. Are the services offered by Lethbridge public accountants close substitutes in the eyes of the buyers?



There are two aspects of the answer to this question. First, the word 'close' is ambiguous in the sense that it is difficult to draw the line between 'close' and 'not close enough'. A most pragmatic approach is simply to find some clear gap in the chain of substitution. Now most customers who require accounting service can turn, to a large extent, either to large accounting firms or to small ones, they can go to highly qualified accountants or less competent ones, they can go to Chartered Accountants or some other public accountants; but with these choices his alternatives appear to end, or at least there is a clear gap between these sets of alternatives and the next substitution possibility. The second aspect of the close demand substitutability of public accountants is price. Products of discernably different quality and prices can be considered close substitutes providing that a change in the price of one product causes a perceptible change, in the same direction, of the demand for the other product. The larger the resultant change in the demand for one product created by the change in price for another the closer they are as substitutes. Also it is possible that one product can be a closer substitute for a second product than the second product is for the first. In the Lethbridge market, services provided by members of



the same accounting association are more likely closer substitutes for each other than the services provided by members of another association; however again the clearest gap in substitutability of products would come after the inclusion of the services from all accounting association members.

(b) Common Group of Buyers: Lethbridge public accountants' services are offered to clients who vary in size from the individual citizen to large manufacturing firms. In this respect the consumers differ; however, they form a common group of buyers by the fact that they all reside in the same geographical area. Due to the costs involved relative to the compensation received, and also the value of the service to the client; an accountant, who practices at a great distance from where the services must be rendered, is not effectively competitive with the public accountants in the locale. Just as a retail store in Calgary is not an effective competitor for a retail store in Edmonton. Thus only clients in a general geographical area can be considered potential customers for the accountants of that area and only public accounts in a general geographical area can be considered competitors in the market.

Since a certain degree of arbitrariness is





unavoidable in defining any market; there are, some exceptions to defining public accounting in Lethbridge as an isolated market. Yet to a large degree it does conform to the economists' ideal industry and by defining the market in this manner we have achieved the grouping together of those firms which operate under the same or similar objective conditions.

#### THE GEOGRAPHICAL AREA OF THE STUDY

The selection of the locale in which to conduct this study was dictated to a large degree by a number of considerations. First, because of the desire to develop a questionnaire which would be adequate for the examination of public accounting over a large area it was deemed necessary to have follow-up interviews with all participating accounting offices. Therefore time and financial constraints necessitated that the study be kept to a manageable size. However the participants had to be of sufficient number that some tentative conclusions could be derived from the results and that the area studied would constitute a "market". Thus the locale had to be of a size large enough for a number of public accounting firms to be providing their services. Finally, since the results of any large study in Alberta would mainly reflect conditions as in Edmonton and Calgary, it was felt that it would be beneficial to the understanding of public





accounting in Alberta to have the results of this small study based on data obtained from a locale other than these two large cities. For these reasons Lethbridge was selected as the geographical area of this study.

Lethbridge is the southernmost city in Alberta, located on the Oldman River near the foothills of the Rocky mountains. It is the third largest city in the province having a population of 40,000 (1970) and serves a trading area with a population of 118,000 (1970).

Lethbridge began as a coal-mining community in the late 1860's. However it was only when the railroad was built through the town in 1885 that Lethbridge began to gain prominence in the area. Thereafter Lethbridge became the distribution centre for the surrounding agricultural region. Until recent years Lethbridge grew steadily but slowly with its economy based almost entirely on agriculture and agriculture-related manufacturing. However, in the sixties Lethbridge experienced a sharp upswing in its rate of growth and its industrial base became increasingly diversified. This growth was given added impetus in the late sixties by the Federal Government's regional development programme. The rate of economic growth in Lethbridge during this period is indicated by the fact that from 1960 to 1970 the gross income of the trading area almost doubled from \$162 million to



\$317 million; that retail trade volume almost doubled in this period from \$51.5 million to \$92 million, and that the value of its manufacturing output increased an amazing 700 per cent from \$20 million in 1960 to \$140 million in 1970.<sup>7</sup> Indications are that this rate of growth will continue.

### THE QUESTIONNAIRE

The primary method of data collection was through the medium of a two part questionnaire.<sup>8</sup> Part A of the questionnaire was sent to all practicing public accountants in the Lethbridge area. This part of the questionnaire was designed to obtain personal information about the public accountants regarding their (1) socio-economic background; (2) formal education; (3) professional background; and (4) income levels.

Part B of the questionnaire was mailed to the office of managers of all public accounting firms in Lethbridge. This part of the questionnaire was designed to solicit data on all aspects pertinent to the operation of the office, such as: (1) accounting association membership; (2) number and types of employees; (3) the income and expenses of the office; (4) the types of services

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<sup>7</sup>. All statistics and various other facts pertaining to Lethbridge were drawn from various brochures provided by the Economic Development Department of Alberta and the Lethbridge Chamber of Commerce.

<sup>8</sup>. The questionnaire used for this study is reproduced as Appendix 1.





provided and the clients served; (5) fee-setting information and fee levels; (6) training programmes; and (7) student employment information.

To supplement the information gained from these questionnaires follow-up interviews were conducted with the office managers of all public accounting firms. During these interviews various ambiguous points concerning the questionnaire were clarified and a number of constructive suggestions were made for the improvement of the questionnaire.

#### METHODOLOGY

Almost all industry studies which have been undertaken have been directed towards the analysis of manufacturing industries. A very powerful methodology for examining these industries was developed by a leading industrial economist, Joe S. Bain. This methodology focuses on the industry's market structure, behavior, and performance. It is this approach that this study employs to examine the economic aspects of public accounting in Lethbridge.

The market structure-behavior-performance methodology postulates that discernable characteristics of the structure of a market interact to create a pattern of market conduct among the firms in the industry. In turn, market conduct provides the link to the performance





of the industry.

Market structure refers to the "factors taken into account by the firm in determining its business policies and practices."<sup>9</sup> This study, in examining the structural characteristics of public accounting in Lethbridge, looks at:

- (1) The forms of ownership of the public account firms in Lethbridge and the accounting associations to which these firms are members.
- (2) The degree of seller concentration in the market.
- (3) The potential elements existing in the market which would permit firms to differentiate their services and the degree to which product differentiation occurs in the market.
- (4) The sources of barriers to entry into the market and the height of these barriers in Lethbridge.
- (5) The restrictions placed on competition from outside the province.

The term "market conduct" alludes to the "overall behavior which the industry's firms display in conducting their business."<sup>10</sup> The behavioral aspects which this study examines are:

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<sup>9</sup>. Jared E. Hazleton, The Economics of the Sulphur Industry, (Washington, D.C.: Resource For the Future, Inc., 1970), p. 3.

<sup>10</sup>. Reed Moyer, Competition in the Midwestern Coal Industry, (Cambridge, Mass.: Havard University Press, 1964), p. 14.



- (1) The degree of interdependence among firms in the market and the mechanisms existing which aid in interdependent coordination.
- (2) The objectives and methods used by firms in setting their fee levels.
- (3) The level and control of the quality of service provided by public accountants in Lethbridge.
- (4) The regulation of advertising and the sales-promotion conduct of firms in the market.
- (5) The market power of firms as buyers of accounting student services and their market conduct in this role.

The concept "market performance" refers to "the degree of effectiveness of the industry's behavior in enhancing the general material welfare".<sup>11</sup> Here, the study deals with:

- (1) A method to determine the degree to which economies of scale are achieved in the market; the extent of chronic access capacity; and a tentative conclusion about the technical efficiency of public accountancy in Lethbridge.
- (2) A method of determining the allocative efficiency of the market and a model for determining the return on public accounting training in Lethbridge.
- (3) An evaluation of the market's performance in the dimensions of size of selling costs, product performance, and progressiveness.

Hopefully the use of the market structure-

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<sup>11</sup>. Ibid.



conduct-performance methodology by forcing the examination of the market's elements in the systematic manner mentioned above will result in providing some insight into the economic aspects of public accountancy in Lethbridge.





## PART I

### MARKET STRUCTURE



Many, if not most, industrial organization economists, are convinced that the elements of market structure are the prime determinants of a firm's conduct in the market place, and that the type of structure which exists in a market will strongly influence the performance of firms in that market.<sup>1</sup>

Market structure refers to "the organizational characteristics of a market", with emphasis on "those characteristics which determine the relationship of sellers in the market to each other, of buyers in the market to each others, of sellers to the buyers, and of sellers established in the market to other actual or potential new firms which might enter the market".<sup>2</sup> That is, it includes "those characteristics of the organization of the market which seem to influence strategically the nature of competition and pricing within the market".<sup>3</sup>

There are many aspects of a market's structure which could be investigated. However, in this study the examination of structural elements will be confined to the key elements of: (1) ownership and control, (2) market concentration, (3) product differentiation, (4) con-

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<sup>1</sup> Louis W. Stern and John R. Grabner, Jr., Competition in the Marketplace, (Glenview Ill.: Scott Foresman and Company, 1970), p. 11.

<sup>2</sup> Joe S. Bain, Industrial Organization, (2d ed., John Wiley and Sons, Inc., 1968), p. 7.

<sup>3</sup> Ibid.



itions of entry, (5) barriers to outside competition.





## CHAPTER I

## OWNERSHIP AND CONTROL

There are several aspects of an accounting firm's ownership and control which are of particular interest since they may have either a direct or indirect effect on the firm's market conduct and performance.

These aspects are:

- 1) Form of Entity.
- 2) Types of Firm.
- 3) Accounting Association Affiliation of Firm.

FORM OF ENTITY

By the form of entity of a firm is meant the legal organization under which services are provided to the public by the firm. The three principal forms of business organization are: (1) individual proprietorship, (2) partnership, (3) limited company.

The forms of entity of the firms practising public accountancy in Lethbridge are as follows:

Individual Proprietorships	10
Partnerships	6
Limited Companies	2

Indeed the small number of limited companies is directly attributable to the restrictions on the forms of entity placed on the practitioners by the accounting



associations of which they are members. Rule 31 of the Code of the Institute of Chartered Accountants of Alberta states:

"No member shall be associated in any way with any corporation engaged in Canada in the practice of public accounting (as defined by the Institute) or an individual or a firm carrying on such practice under non-personal title or name except as otherwise provided in these rules".<sup>1</sup>.

This rule is then augmented by Guideline 31.2 which permits the use of the corporate form of organization for certain activities which are considered non-core professional functions; such as management consulting, estate planning, and data processing, providing these firms do not describe themselves as "Chartered Accountants".<sup>2</sup>.

Emulating the Chartered Accountants, the Association of Accredited Public Accountants of Alberta have a similar rule in their Code of Ethics and practitioners with no accounting association affiliation have also to a large extent accepted this practice.

The various arguments advanced for the need to forbid the practice of public accounting under corporate form can be summarized into the one central argument that it prevents the establishment of a proper personal and

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<sup>1</sup>. Institute of Chartered Accountants, Code of Ethics, 1970, Rule 31.

<sup>2</sup>. Ibid., Guideline 31.2.



fiduciary relationship between practitioner and client.<sup>3</sup>

It is also thought that public accountants who formed a corporation might be tempted (or suspected of being tempted) to take risks which they would not assume if they were personally fully responsible for their acts. Further it is thought that controlling interest of the impersonal corporation might be gained by a non-professional whose major interest would be financial gain and he might be able to dictate the policies of the firm to the detriment of the accounting profession and public interest. Notwithstanding the argument that the practitioner's knowledge of his unlimited financial liability could be regarded as a practical stimulus to responsible conduct towards his client's affairs that might be absent if liability was limited, most arguments made for restricting the corporate form of organization for public accountants are exaggerated and for the most part merely reflect traditional views of the older professions. It is not apparent that the formation of a limited company would necessarily impede the establishment of personal and fiduciary relationships' between practitioner and client especially since the continuing personal attention by the

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<sup>3</sup>. Great Britain, Monopolies Commission, Command Paper No. 4463, Vol. 1, (London: Queen's Printer, 1970), p. 37.





same practionery is not of paramount importance. Bank, investment and insurance firms carry on confidential relationships with their clients without the aid of this restriction. Nor are clients or the public today more likely to suspect a corporate practioner of being any less responsible than a member of any other form of business. In their own self-interests corporations can and do have a strong sense of responsibility: it is very unprofitable to neglect the customer's interest, and a deserved reputation for responsibility to the customer promotes demand for the corporation's services. Finally, fears that a company might pass into irresponsible hands or that exploiting companies might be formed may be considered to be exaggerated since safeguards against such developments can easily be applied. It could be stipulated that all or a given number or proportion of the directors of a company offering the professional service should be qualified practioners.

On the other side of the coin, arguments can be made which make prohibitions on corporate forms detrimental. There are a number of ways in which this restriction might impede the growth of the firm and although size and efficiency are not necessarily correlated there is probably a minimum size for efficient operation which is larger than a one-accountant office.<sup>4</sup> The corporate

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<sup>4</sup>. Infra, p. 146



form might in the long term make it somewhat easier for an accounting firm to accumulate capital. Also insofar as the life of a corporation is not terminated by the death or retirement of a practitioner, a corporate business might be more attractive to qualified staff; it might therefore be better able to compete with industry for the services of such staff. Finally it might also make it easier for the practitioner to obtain capital from outside investors but it does not follow that he necessarily would.

The main concern of the above discussion has been to examine whether or not the restrictions imposed by certain accounting associations and the resultant accepted practice in public accounting is in any way to the benefit of the client or in the public interest. It is the opinion of this writer that the benefits of this restriction are negligible and in fact it might have detrimental effect which outweigh any benefits. Thus associations which have such restrictions should eliminate them and public accountants in general should reconsider the rationale behind their form of organization. It should be noted that the freedom to form limited companies would still leave those practitioners who wished to practice with the traditional form of organization and clients who wished to engage only non-incorporated



firms free to do so.

#### TYPES OF FIRM

Another means of viewing the ownership and control elements of a public accounting firm is to ascertain the number of offices maintained by the firm. From this point of view the firm could be considered a national or international firm when it has offices in more than four provinces, a Regional firm when it has offices in four or fewer provinces, a Provincial firm when it has more than one office in the province, or a local firm when it has only one office. The type of firm to which an office belongs can have an important effect on the amount of highly specialized talent the practitioners have available for consultation, on the quality of service provided to clients, on the research done by the firm, on the level of the fee structure, and also to some extent on the sensitivity to the community's needs.

In Lethbridge all firms are of the local type except one. The exception is an office of an international firm which specializes in the completion of personal income tax forms for its customers. (In its slower season it also provides courses to the public pertaining to basic Income Tax preparation.)





The absence of any international, national, regional, or even provincial firms in Lethbridge can be directly attributable to the type of clients in the area demanding the services of public accountants. Until recent years, most clients of the public accountants were also of the local nature, very few national manufacturing firms were located in the region. Thus local public accounting firms could adequately provide the accounting services required and, most likely, the larger public accounting firms could see little benefit to be gained by opening an office in the area. However, in recent years this situation has changed rapidly; more and more national business firms are establishing offices and plants in this area. This development was given added impetus by the incentives provided to manufacturing firms establishing in the area by the Federal government's regional development program. Thus it is quite likely that in the next several years the larger accounting firms will begin to establish offices in Lethbridge. Quite probably this will occur, as it has in other areas, by these firms merging with the already established local firms.

#### ACCOUNTING ASSOCIATION AFFILIATION OF FIRMS

The most important aspect of ownership and control which can be identified is the national or provincial



accounting association with which firms are affiliated. A provincial association, by requiring that its members strictly adhere to its by-laws, rules and regulations or face the association's disciplinary action, can potentially exercise great control over the activities and operations of its members and therefore be a major influence on the market conduct and market performance of members firms. The disciplinary action of the accounting association can include a reprimand, a fine, a suspension, or even the expulsion of the offending member. The provincial association which imposes the strongest influence on the conduct and performance of its members is the Institute of Chartered Accountants of Alberta. Its members make up the elite of public accountants in Alberta. It is also the only public accounting association which has been officially recognized by the Alberta government by legislation known as the Alberta Chartered Accountants Act. Other public accounting associations have gained semi-official recognition under the Societies Act of Alberta.

The main control over ownership which the Alberta Institute of Chartered Accountants imposes on its membership is found in Rule 33 of its Code of Ethics:

"No member shall be associated with any firm practising as chartered accountants



in Alberta unless:

- (a) all partners resident in Alberta are members,
- (b) at least one partner is a member,
- (c) all partners are members of the Canadian Institute of Chartered Accountants,
- (d) such firm complies with the by-laws, rules and regulation of this Institute".<sup>5</sup>.

This ruling outlines the qualifications which practioners should have in order to hold any ownership in a firm practising public accounting as Chartered Accountants. If all these conditions are not fulfilled, the firm may practice public accounting but can not describe itself as a Chartered Accountants firm.

In Lethbridge there are eighteen firms which hold themselves out to the public as public accounting firms. These firms were found to be members of either the Alberta Institute of Chartered Accountants, the Accredited Public Accountants of Alberta, or were independent firms having no accounting association affiliation. The actual number of firms in each category were:

Chartered Accountant Firms	5
Accredited Public Accountant Firms	6
Independent Firms	7

The Accredited Public Accountants which just recently formed a provincial association in Alberta has

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<sup>5</sup>. The Institute of Chartered Accountants of Alberta, Code of Ethics, Rule. 33.





rapidly grown in membership in the area. Since most unaffiliated firms in the area can meet the entrance qualifications of this association,<sup>6</sup> and as membership of any accounting association tends to provide the practitioner with added prestige and acceptability by the public; it is quite likely that a number of the firms which are not now affiliated with any association will join this association.

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<sup>6</sup>. For a full discussion of these entrance qualifications see infra, p. 53



## CHAPTER II

## MARKET CONCENTRATION

Economic theory predicts that the market conduct and performance of firms will be influenced by the structure of the markets in which they buy and sell. It also predicts that one of the strategic aspects of market structure is the degree of economic concentration involved. In general, the degree of economic or market concentration refers to the number and size distribution of sellers in the market.<sup>1</sup>

To explain why market conduct and performance can be expected to respond to variations in seller concentration we must examine briefly the theoretical reasoning which links concentration to conduct and performance, through the strength of the mutually recognized interdependence among sellers. In any such market a seller has two conflicting desires. First, he would like to act cooperatively with all sellers to establish a price and output level which would yield maximum joint profits to all sellers. But, secondly, he would desire to increase his share of the joint profits and therefore his

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<sup>1</sup> Louis W. Stern and John R. Grabner, Jr., Competition in the Market place, (Glenview, Illinois, Scott, Foresman and Company, 1970), p. 13.



own profits at the expense of his rivals. Whether the firm will act separately or cooperate with rivals will depend on the relative strength of the two motivations in the individual market situation. If there are few sellers, each having a significant share of the market and buyers reacted to any price changes by any of the competitors, then the other firms would experience significant changes in their market shares and react accordingly; thus all firms would be induced to act more cooperatively. Whereas if a firm had only a small market share then any price adjustments it made would not significantly influence the market position of the larger sellers or induce them to any reaction, this the small firm would be more strongly motivated to act independently. However if there were a large number of these small firms acting in this independent manner their combined actions would effect the market position of the few large sellers and thus deter these firms from setting price and output levels which maximized joint profits. Therefore it can be concluded that the higher the degree of seller concentration the greater will be the tendency toward cooperative action to establish a joint-profit maximizing price and output. Also, it can be concluded that the existence of a competitive fringe tends to result





in market prices lower than they would be if no such fringe existed, although the degree to which prices will be lower will depend on the competitive disadvantages of the fringe firms and their aggregate market share.<sup>2</sup>

#### MEASUREMENT OF MARKET CONCENTRATION

A number of approaches are used by economists to measure market concentration including the Lorenz Curve, the Gini Coefficient, the Herfindahl index, and market concentration ratios.<sup>3</sup> Fortunately, the chances of making a serious analytical error in the choice of which market concentration measure to use is slender, for the principal concentration indicators all display similar patterns.<sup>4</sup>

Thus for this study the market concentration ratio will be used since it satisfactorily copes with inequality aspect of the varying market shares of the rival firms. For it is a firm's absolute size relative to its market that is of prime importance. The market concentration ratio is defined as ".... the percentage of total industry sales (or physical output, or employment, or value added, or assets) contributed by the largest firms."<sup>5</sup> The most commonly used variant is the

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<sup>2</sup>.Bain, Industrial Organization, pp. 118-123.

<sup>3</sup>.Scherer, Op. cit., pp. 56-57. The author provides an excellent review of these methods and their limitations.

<sup>4</sup>.Ibid., p. 52.

<sup>5</sup>.Ibid., p. 51.



percentage of total industry sales made by the leading four firms. The use of the sales concentration ratio for an industry tends to provide an indication of somewhat higher degree of concentration than does the use of the employment concentration ratio for the same industry.<sup>6</sup>

#### CONCENTRATION OF PUBLIC ACCOUNTING IN LETHBRIDGE

In Part B of the questionnaire, questions 3 (a) to (f) inclusive were designed to provide information as to the number of people in Lethbridge employed in public accounting and the positions these people held with the firms. The following table presents the results classified according to the association affiliation of firms:

TABLE 2.1  
EMPLOYMENT IN PUBLIC ACCOUNTING  
IN LETHBRIDGE

	Chartered Accountant Firms	Accredited Public Account Firms	Independent Accountant Firms
Individual Practitioners or Partners	19	7	8
Managers	3	-	1
Full-Time Staff Accountants	7	-	-
Students	31	-	-
Other Full-Time Staff	16	5	4

<sup>6</sup>. Ibid., p. 52.



Another approach to viewing this information is to look at the number of full-time employees per office, or the size of the various offices when classified according to their association affiliation. Table 2.2 presents the data tabulated in this manner:

TABLE 2.2  
FULL-TIME EMPLOYEES PER OFFICE

Number of Full-Time Personnel	Chartered	Accredited	Independent
	Accountants Firms	Public Accountants Firms	Accountants Firms
one	-	2	3
two	-	3	2
three	1	1	2
4-10	-	-	-
11-15	1	-	-
16-20	1	-	-
21-25	-	-	-
26-30	2	-	-

As is apparent from the above tables the Chartered Accountant firms are the much larger firms in the area. In Lethbridge there are a total of 101 persons deriving their incomes mainly from public account-





ing. There are another 19 persons supplementing their main source of incomes by part-time employment in public accounting. These part-time employees were found to be evenly dispersed among all public accounting firms with the exception of the firm specializing in income tax returns which makes use of several part-time employees during its busy season.

An employment concentration ratio can be derived for Lethbridge which shows the extent to which Chartered Accountant firms dominate the market. This can be done by slightly modifying the traditional "leading four firms ratio" to include the one other small accounting firm. Table 2.3 provides the concentration data for public accounting in Lethbridge:

TABLE 2.3

THE EMPLOYMENT CONCENTRATION RATIO OF  
PUBLIC ACCOUNTING IN LETHBRIDGE

Chartered Accounting Firms	70.5
Accredited Public Accounting Firms	11.3
Independent Firms	12.2

Before discussing the implications of the employment concentration ratio derived above this data will be supplemented by an approximate sales concentration



ratio for the area by accounting association affiliation of firms.<sup>7</sup> Since the question concerning gross fees was asked to be answered only in income ranges to obtain a better response, the data on Table 2.4 provides only the approximate sales concentration ratio of the area.

TABLE 2.4

THE SALES CONCENTRATION RATIO OF  
PUBLIC ACCOUNTING IN LETHBRIDGE

	Percentage of Market's Gross Fees
Chartered Accountant Firms	85.7
Accredited Public Accountant Firms	5.5
Independent Firms	8.8

From the above tables it would appear that both the employment concentration ratio and the sales (or gross fees) concentration ratio indicate high concentration in Lethbridge's public accounting market with the sales concentration ratio indicating a higher concentration than the employment concentration ratio. However the ratios themselves are mere numbers and meaningless unless they can be compared to similar ratios

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<sup>7</sup> Unfortunately, a break-down of the percentage of the market's gross fees by firm cannot be provided since, due to the fewness of firms, the confidentiality of response of the firms might be jeopardized.



of different industries to ascertain what degree of concentration their absolute values actually indicate comparatively.

Professors Carl Kaysen and Donald F. Turner provided a loose guideline for categorizing markets according to their concentration levels. It was a three-way division of market as follows:

1. Highly concentrated oligopolies - a Big Eight with 5- per cent or more of shipments...
2. Less concentrated oligopolies - a Big Eight with 33 per cent to 50 per cent of shipments...
3. Markets considered unconcentrated - a Big Eight with less than 33 per cent of shipments.<sup>8</sup>

Professor Bain also provides a tentative classification of industries based on seller concentration. This is "a sevenfold classification which takes account not only of the degree of top-level concentration, but also the total number of sellers in the industry and their size distribution in general".<sup>9</sup> Type I-a is considered to be the most highly concentrated market category, with very high concentration of total output in the hands of the largest three or four firms and a very small total number of firms. Bain's Type I-b is very relevant to

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<sup>8</sup>. Carl Kaysen and Donald F. Turner, Antitrust Policy: An Economic and Legal Analysis, (Cambridge, Mass.: Harvard University Press, 1959), pp. 187-188.

<sup>9</sup>. Bain, Op. cit., p. 139.





the situation in Lethbridge. Type I-b category includes industries which have very high concentration of output in the hands of the largest three or four firms (over 75 per cent); but in industries in this category either somewhat more sellers have important market shares or there is a more numerous competitive fringe of small sellers.<sup>10</sup> In this category, the existence of a very high degree of mutually recognized interdependence is likely. And although the competitive fringe might possibly affect the character of competition to a degree, it is most probable that either through disadvantages in costs or buyer evaluation of their product the small firms presence will have only a slight actual or potential influence on industry conduct and performance.<sup>11</sup>

Public Accounting in Lethbridge quite readily fits Bain's Type I-b concentration category and thus can be designated as being 'very highly concentrated'. This would suggest that there would be a strong propensity for the principal firms to pursue cooperative policies. However there are other factors which must be considered before concluding that because public accounting in the area is highly concentrated, the industry is necessarily performing in a socially undesirable fashion.

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<sup>10</sup>. Ibid., p. 138.

<sup>11</sup>. Ibid., pp. 138-139.



## CHAPTER III

## PRODUCT DIFFERENTIATION

Another important element that must be considered in evaluating the structure of any market is the extent and significance of product differentiation within the market. The degree of product differentiation refers to or measures the extent to which "buyers differentiate, distinguish, or have specific preferences among competing outputs of the various sellers established in an industry ... or in technical terms, it measures the degree of imperfection of substitutability (to buyers) of the various outputs of an industry".<sup>1</sup> The greater the ability of a firm to differentiate its product or, in the case of public accountants, to differentiate the services his firm provides, the more inelastic its demand curve will be; i.e. the more it will be able to raise prices without suffering the loss of a substantial volume of work.

CAUSES OF DIFFERENTIATION

The existence of product differentiation is explained by the factors which might induce buyers to

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<sup>1</sup> Bain, Industrial Organization, p. 223.



prefer one competing product or service to another. A number of these factors or causes are very pertinent for public accounting. The most obvious one is differences in the quality of service provided. One client may be quality-conscious and be willing to pay a considerable price premium to ensure high quality service whereas another may be price-conscious and accept a lower quality service if there is a price concession. Indeed it is in the public interest for quality differences to exist among firms in public accounting since a considerable volume of accounting work is routine and does not require the attention of a highly-qualified accountant, instead this service could be provided by accountants with less extensive training and experience. For a highly qualified accountant to do this type of work would be a misuse of a highly valuable resource of society.

A second source of product differentiation is the ignorance of buyers regarding the essential characteristics and qualities of the services they are purchasing. Most professions argue that because of special skills inherent in the service they provide the public frequently lacks the ability to judge the relative merits of professional services. The most highly qualified public accountants also make this claim. "They have to trust





him, since they cannot appraise the quality of his service. They must take it on faith that he is competent..."<sup>2</sup>.

Thus 'credat emptor' (let the buyer believe) creeps in to replace 'caveat emptor' (let the buyer beware) in certain aspects of public accounting. It is because of this ignorance or the uncertainty of potential clients with certain aspects of accounting that accounting associations gain one of their major justifications for existence. As Professor D. S. Lee aptly states:

"Professional associations may be regarded as a response to consumer uncertainty, as a means to enable consumers to distinguish qualified from unqualified practitioners and to give a strong indication of certain minimum standards of competence."<sup>3</sup>.

Although the existence of accounting associations may reduce consumer uncertainty in distinguishing the degree of competence and the standards of members of the various associations, their existence does nothing to aid the potential client in judging the varying degrees of quality of service among members of the same association. In these circumstances, the consumer is likely to rely on the past performances and the reputation of firms.

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<sup>2</sup>. John L. Carey and William O. Doherty, Ethical Standards of the Accounting Associations, (New York: American Institute of Certified Public Accountants, Inc., 1966), p. 4.

<sup>3</sup>. D. S. Lee, Economic Consequences of the Professions, (London: The Institute of Economic Affairs, 1966), p. 32.



A third cause of product differentiation in public accounting is gained through the legal framework in society. When legislation is passed which prohibits the use of a name or other designation by any person other than members of a certain association, the law is in effect providing the association's members with a 'brand-name' identification. For example:

"17 (1) No person shall take or use the designation "Chartered Accountant" or the initials "F.C.A." or "A.C.A.", or any name, title or description implying that he is a chartered accountant, unless he is a member of the Institute in good standing and registered as such.

(2) A person taking or using a name, title, initials or description contrary to subsection (1) is guilty of an offence and liable to a fine not exceeding fifty dollars for each offence".<sup>4</sup>.

Thus with this law members of the Institute of Chartered Accountants of Alberta have the exclusive use of a name with which the public can associate with public accounting. For the reasons explained above this can be important factor in the demand for their services.

A fourth possible means of developing product differentiation is through sales-promotion activities,

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<sup>4</sup> Government of Alberta, The Alberta Chartered Accountants Act, Office Consolidation, (Edmonton: Queen's Printer, 1965), Sec. 17.



particularly advertising. Advertising and other sales promotion can be primarily for informational purposes; but, as is readily apparent, most of today's advertising is primarily "persuasive". Advertising by firms is not permitted by accounting associations (a subject which will be discussed in a later chapter), but other promotional activities such as newsletters, luncheons, club memberships, and speaking engagements are considered ethical means of informing potential client's of the firm's ability. Yet some restrictions are placed even on these activities. However, the associations themselves may advertise to make the public more aware of the skills of its members.

A final source of product differentiation which can occur is the provision of a certain kind of accounting service, or the provision of accounting services to a certain type or size of client, i.e. market segmentation. Firms may find it very profitable to gain a reputation for providing a particular type of service.

#### PRODUCT DIFFERENTIATION OF PUBLIC ACCOUNTING IN LETHBRIDGE

There are two aspects of product differentiation to examine in relation to public accounting in the area, these are inter and intra-association product differentiation. A series of questions were asked in the survey which directly examine the degree of product differentia-





tion which is occurring in respect to inter-association product or service differentiation. The following tables present the results of those questions:

TABLE 3.1  
TYPE OF WORK PERFORMED

	Chartered Accountants	Accredited Public Accountants	Independents
	Percentage	Percentage	Percentage
Auditing	22.5	-	2.0
Taxes	23.8	16.8	43.0
Management Services	13.7	-	2.0
Preparation of Client's Statements and Records	31.7	75.0	49.0
Other public accounting work	8.3	8.2	4.0



TABLE 3.2

## ACTIVITIES OF CLIENTS

	Chartered Accountants	Accredited Public Accountants	Independents
	Percentage	Percentage	Percentage
Agriculture, Forestry, Fisheries	21.3	5.0	23.8
Mining, Oil exploration	5.0	-	-
Construction, Manufacturing	17.5	46.7	9.1
Transportation, Communication, Public utilities	7.4	-	2.0
Wholesale and Retail Trade (including Cafes)	11.2	20.0	35.6
Services, Hotels, Entertainment	20.0	16.7	16.1
Non-profit organizations, government, reli- gious, charitable, private persons	13.8	11.6	12.4
Finance, insur- ance, real estate	3.8	-	1.0



TABLE 3.3

## SIZE OF CLIENTS

	Chartered Accountants	Accredited Public Accountants	Independents
	Percentage	Percentage	Percentage
Less than 10 employees	35.0	86.7	97.0
10-99 employees	53.8	13.3	3.0
100-499 employees	8.7	-	-
500 employees or more	2.5	-	-

TABLE 3.4

## PROMOTIONAL EXPENSES

	Chartered Accountants*	Accredited Public Accountants	Independents
	Percentage	Percentage	Percentage
Less than \$250	25.0	100.0	100.0
\$250 - \$499	-	-	-
\$500 - \$999	25.0	-	-
\$1000 - \$2499	50.0	-	-
More than \$2500	-	-	-

\* One firm was not prepared to disclose this information.





The tables indicate that inter-association product differentiation does occur. But it is only Chartered Accountants who have been able to differentiate their service from other public practitioners to any large degree. The inability of Accredited Public Accountants to gain any differentiation between themselves and independent practitioners may be due to their recent provincial formation as an association and the public's lack of awareness of their standards and qualifications. Differentiation has occurred for auditing and management services provision with Chartered Accountants providing virtually all of these services. It has also occurred for the provision of accounting services to larger clients as could be expected since these clients would have more complex accounting problems and would need the services of more accountants than the small public practitioners could adequately supply. It appears, from Table 3.2 that service differentiation does not occur in relation to clients business activities. Table 3.4 indicates that it is only Chartered Accountants who spend any amount of money annually on "ethically" establishing or improving client relationships. In fact in follow-up interviews it was ascertained that most other public accountants spend less



than fifty dollars annually on these activities. However the international firm which specializes in the preparation of tax returns does spend larger amounts on advertising (not considered ethical by the accounting associations) and has reaped benefits from doing so.

Intra-association product differentiation in the area was more difficult to perceive. Certainly, with the exception of the firm specializing in the preparation of income tax returns, no service differentiation occurs among either Accredited Public Accountants or independent Accountants. Among Chartered Accountants a certain degree of differentiation does appear to occur because of the established reputations of the older firms and also because of the varying sizes of these firms. The larger clients prefer the services of the largest accounting firms. Again this is probably because only these firms can supply them with sufficient service. However even this degree of product differentiation is slight. Thus one can conclude that in Lethbridge intra-association service differentiation is relatively unimportant whereas inter-association differentiation play a major role.



## CHAPTER IV

## CONDITIONS OF ENTRY

Both concentration and product differentiation, as we have seen, are major elements of an industry's market structure. Both are important features of the economic environment of the firm and are effective parameters within which firms must make decisions in their pursuit of profits; therefore knowledge of these elements aid in predicting how the firms in a market are likely to behave. Another structural determinant which is as important as seller concentration and product differentiation in influencing a firm's economic environment and therefore its conduct and performance, is the conditions of entry into an industry. The condition of entry measures the degree of difficulty of entry, or the disadvantages that new competitors will encounter if they try and compete in the market. Bain, in his pioneering work on manufacturing industries, advances the following general definition of the term "conditions of entry".

"the advantages of established sellers in an industry over potential entrant sellers, these advantages being reflected in the extent to which established sellers can persistently raise their prices above a competitive level without





attracting new firms to enter the industry".<sup>1</sup>.

However a notable aspect of the conditions of entry into an industry is that different firms frequently have different degrees of advantage over potential entrants just as different potential entrant firms often have differing degrees of disadvantage as compared to the most advantaged firms in the market that they might enter. In situations where these circumstances exist, the term the "immediate" condition of entry is used to define "the advantage of the most advantaged established firm or firms over the least disadvantaged potential entrant or entrants"<sup>2</sup>. and the "general" condition of entry refers to the successive degrees of advantage which the most advantaged established firm or firms have over increasingly more disadvantaged entrant firms.<sup>3</sup>. Thus in the case of public accounting the "immediate" condition of entry is the degree of advantage that the most well-entrenched and profitable Chartered Accountant firm or firms in the market would have over the most highly reputed Chartered Accountant or group of Chartered Accountants who could establish a practice in the vicinity.

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<sup>1</sup>. Joe S. Bain, Barriers to Competition, (Cambridge: Harvard University Press, 1956), p. 3.

<sup>2</sup>. Ibid., p. 9.

<sup>3</sup>. Ibid.



The immediate condition of entry at any time will potentially exercise the strategic proximate influence on the pricing policies of established firms.

Thus, whereas seller concentration and product differentiation among established sellers in a market presumable influence the market relationship among existing sellers; the condition of entry determines:

"the competitive relationships between established sellers and potential entrant sellers, and thus in a sense the force of potential or latent competition by new entrants."<sup>4</sup>.

It is because of the fact that both actual new entry, or the threat of it, do influence market decisions that this element of market structure is important.

In general there are a number of sources of barriers to entry into an industry but these sources vary among industries. For example, absolute cost barriers and scale economies barriers play a large role in heavy manufacturing industries whereas they are inoperative in public accounting. An absolute cost

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<sup>4</sup>. Joe S. Bain, Industrial Organization, p. 251.



barrier is erected when established firms, at any comparable scale of operation, would have lower production and distribution costs than those of potential entrants. This can occur because established firms through patents or secrecy, control superior production techniques or have exclusive ownership of superior deposits of resources needed in production; or can acquire the necessary factors of production on more favorable terms than potential entrants.<sup>5</sup> Scale economies barrier occur when the minimum optimal scale of the industry supplies a significant portion of the industry's output and output on a smaller scale entails considerably higher unit costs.<sup>6</sup> Because of the nature of public accounting neither of these sources are operative or barriers to entry in that industry. However there are several potential sources of barriers to entry into public accounting in Alberta which require examination. These include: (1) legal restrictions on entry; (2) certification of association members; (3) product differentiation.

#### LEGAL RESTRICTIONS ON ENTRY

It is within the power of the provincial govern-

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<sup>5</sup>. Ibid., p. 260-261.

<sup>6</sup>. Ibid., p. 363.





ment to regulate the conditions under which anyone may practice public accounting. The provincial government can specify that persons wishing to practice any aspect of public accounting meet certain qualification standards on it can reserve certain specified areas of practice to those it designates as qualified. A number of provinces, among them Ontario, Quebec and Nova Scotia have legislated licensing acts for all public accountants setting the minimal qualification standards for public accountants. However the Alberta government has not felt this step necessary. Thus anyone can hold himself out as a public accountant if he so desires, whether or not he has any degree of competence in the field. In fact the provincial government has felt there was no need to officially reserve even the area of public accounting where public interest would be most at stake - the auditing of public companies - to those with proven qualifications. Eligibility for appointment as an auditor of a public company is set out in the Companies Act of Alberta and states:

"(1) Except as provided in subsection (2), no person shall be appointed as auditor of a company who is a director, officer or employee of that company or an affiliated company or who is a partner, employer or employee of any such director, officer or employee".<sup>7</sup>.

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<sup>7</sup>. Government of Alberta, The Companies Act, (Edmonton: Queen's Printer), Sec. 117, Subsect. (1).



Subsection (2) goes on to lessen this restriction on eligibility for private companies. However, as stated before, the government has enacted legislation which incorporates the Chartered Accountants in Alberta, providing this accounting association with official government recognition. Yet a specific section was inserted in this Act to preserve the rights of non-members to practice public accounting:

"Nothing in this Act affects or interferes with the right of a person not a member of the Institute to practice as an accountant, or with the right of a person not residing or having an office within Alberta to use any designation as accountant."<sup>8</sup>

Thus it can be seen that provincial legal restrictions on entry are negligible, certainly much less severe than those imposed elsewhere in Canada; therefore, these restrictions do not create barriers to entry into public accounting in Alberta.

#### CERTIFICATION OF ASSOCIATION MEMBERS

The degree to which certification<sup>9</sup> creates barriers to entry depends upon the effect of the certification on the relevant demand functions and on the strict-

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<sup>8</sup>. Government of Alberta, The Alberta Chartered Accountants Act, Sec. 32.

<sup>9</sup>. Certification is the term used by Professor M. Friedman to designate when the law permits an association the right to set the qualification standards of its members, and the right to exclusive use to some designation that can be used to show competence to prospective customers and clients; but does not permit the association's members exclusive rights to provision of those services. Milton Friedman, Capitalism and Freedom, (Chicago: University of Chicago Press, 1962), p. 144.



ness of the certification requirements. There are a number of accounting associations in Alberta; for example, The society of Industrial Accountants and The Certified General Accountants Association are two which have not been previously mentioned. Each of these associations has its own qualification standards; however, since no members of either of these associations are practicing public accounting in Lethbridge only the admission qualifications of Accredited Public Accountants and Chartered Accountants, the two accounting associations represented in the area, will be examined in this study.

Accredited Public Accountants: Qualification for membership is outlined in the Associations by-laws as follows:

"Under such terms and conditions as the council may prescribe, certificated membership in the association shall be opened to:

- a) Any resident of the Province of Alberta who has practiced as a public accountant for a period of five years or who is a member in good standing of any association of accountants and auditors incorporated by or under authority of an act of the Parliament of Canada or of the Legislature of any of the provinces of Canada, the qualifications for membership in which are in the opinion of the council equivalent to those established for the association.
- b) Any person of the full age of twenty-one years who has successfully passed the examinations prescribed by the council





and who has satisfied the council that he has either

- 1) held himself out as a public accountant in full time practice for a period of three years; or
- 2) served for one year as a clerk or assistant to a full time practicing accredited public accountant or to any member in good standing of any association of accountants or auditors incorporated by or under the authority of any act of the Parliament of Canada or of any of the legislatures of any of the provinces of Canada".<sup>10</sup>.

Eligibility to become a student of the association's course requires that the applicant show proof that he has at least obtained a High School Graduation or an equivalent combination of experience and maturity. Thus it can be seen that certification as an Accredited Public Accountant does not create much of a barrier to entry to any aspiring practitioner.

Chartered Accountants: The admission requirements to practice as a Chartered Accountant may be divided into two classes: educational and non-educational qualifications. The required qualifications are outlined in the Alberta Chartered Accountants Act and are stated as follows:

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<sup>10</sup>. Accredited Public Accountants Association of Alberta, By-Laws, Sec. 12.



"A person shall be admitted as a member of the Institute who:

- (a) produces a certificate from the General Faculty Council pursuant to section 13,
- (b) produces a certificate from the Accountants Experience Appraisal Board pursuant to section 14,
- (c) is either a Canadian citizen or has filed a declaration of intention under the Canadian Citizenship Act
- (d) is of the full age of twenty-one years
- (e) has shown himself to be of good character and reputation
- (f) has satisfied the secretary of the Institute that his name has not been removed for cause from the register of any accountants' institute, association, society, college or any similar body in Canada or elsewhere, and
- (g) pays the prescribed fees."<sup>11</sup>.

Subsections (a) and (b) may be designated the educational qualifications and further explanation of these subsections should be given. The General Faculty Council which was referred to in subsection (a) is that of an appropriate university in Alberta. It issues a certificate to a candidate for admission to membership in the Institute on the condition that this person has acquired educational qualifications which are equivalent to those required by the Institute of Chartered Accountants of Alberta at that time. The Chartered Accountants' course of instruction consists of sixteen subject-area courses. In addition

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<sup>11</sup>. Government of Alberta, Chartered Accountants Act, Sec. 15.



to completing and passing these specified courses, a person must also write and pass the Uniform Final Examinations for Chartered Accountants in order to receive such a certificate recognizing his educational qualifications. Accordingly, the Accountants Experience Appraisal Board referred to in subsection (b) issues a certificate to a person when it adjudges he has the necessary training and practical experience to allow him to practice as a Chartered Accountant. The practical experience required is dependent on the courses of study which a person undertook in acquiring his educational qualifications. The minimum number of years of practical experience obtained during employment in a Chartered Accounting firm required for a high school senior matriculant, university degree, and a Bachelor of Commerce with an Accounting major or a Master of Business Administration degree are five, three and two respectively. It is also important to note that since September 1, 1970, a baccalaureate degree of any recognized provincial university is the minimum educational qualification for a student to even register in the Chartered Accountants' course of instruction.<sup>12</sup>. The fee requirements referred to in subsection (g) are quite nominal with an admission fee of \$150.00 and annual fees

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<sup>12</sup>. The Institute of Chartered Accountants of Alberta, By-laws, Sec. 30 (1) (a).





of \$50.00.<sup>13.</sup>

It becomes readily apparent that certification as a Chartered Accountant is a high barrier to entry, especially with the present educational requirements needed to even register as a student. The necessity of having a baccalaureate degree to become eligible for training not only raises the academic barriers it also raises the financial barriers. Now a person aspiring to be a Chartered Accountant must be able to first afford the expenses of acquiring a university education. The financial barriers are raised further by the costs of years spent as a student especially in terms of income foregone by the student.

#### PRODUCT DIFFERENTIATION

From the view-point of inter-associational differentiation this source of barriers to entry is directly linked to the preceding discussion and the disadvantages of other public accountants to Chartered Accountants; however it is of interest separately from an intra-associational point of view due to the prohibition by the accounting associations of advertising. The situation in public accounting is the reverse of what can occur in manufacturing industries where advertising

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<sup>13.</sup> Ibid., Sec. 45 and 48 (a).



can create major barriers to entry.<sup>14</sup> In public accounting the inability to advertise can create a barrier to entry. Without advertising to make potential clients aware of his practice, the entrant can only build up its practice slowly, gaining customers only through social contacts, referrals, etc. This method has high financial costs in terms of the income the new entrant must forego while waiting for his practice to grow and also possibly because he would have to accept low-priced routine work rather than the higher-priced complex accounting services he is able to perform. This source of barrier to entry is likely to create higher barriers in a large city than in a smaller one, since the smaller the size the more quickly he can become known to potential customers.

#### CONDITION OF ENTRY TO PUBLIC ACCOUNTING IN LETHBRIDGE

In the Lethbridge area the component barriers are found in various degrees of strength. Certification does create a major barrier for aspiring Chartered Accountants of the area since firms feel they cannot justify the higher salaries which they would have to pay for students entering with these education qualifications:

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<sup>14</sup> Bain, Industrial Organization, pp. 282, 288-290.



in all cases the established firms will tend to decrease their yearly intake of Chartered Accountant students and instead begin taking on persons who are students of other accounting associations.<sup>15</sup> Yet, though this barrier is high the "immediate" condition of entry is very low, since the least disadvantaged potential entrant would be a national or regional firms which up until now has not established any offices in Lethbridge. The reputations which these firms would bring with them would, at the most, leave them at a slight disadvantage for only a very short period of time. Also there are Chartered Accountants working for government or industrial concerns who could enter the market; although these persons would be at a slightly greater disadvantage. Product differentiation creates fairly large interassociation barriers between Chartered Accountants and other practioner, however any product-differential advantage that established Chartered Accountant firms have over the entrance of new small Chartered Accountant firm due to its inability to advertise would be not very large due to the small size of Lethbridge. This barrier is probably higher for other public accountants.

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<sup>15</sup>. This information was gained in interviews with members from all of the Chartered Accountant firms.





From these observations it can be concluded that overall there are 'moderate to low' barriers to entry and thus the condition of entry into public accounting in Lethbridge is probably either "ineffectively impeded" or "easy".



## CHAPTER V

## BARRIERS TO OUTSIDE COMPETITION

The final element of market structure which will be examined is the restrictions placed on competition from outside the province. In the discussion of this structural determinant it is not necessary to distinguish between Lethbridge and the rest of the province since any territorial barriers erected for the province in general will apply for Lethbridge also. If the barriers to outside competition are sufficiently high, public accountants in general could set price levels which would provide higher incomes from their activities than could be achieved outside the province without the fear that outside practitioners, attracted by the higher incomes, would enter the market. However if these barriers are low then pricing decisions in general would be influenced by that fact that prices which produced incomes much higher than those achieved for similar work outside the province would quickly attract new entrants in the market.

Barriers to outside competition could be erected either by the government or by the various accounting associations. The government could pass



legislation which would limit the practicing of public accounting or some areas of this service to resident firms. An extreme example of this is Florida which passed legislation which prohibits accountants from practicing their profession in branch offices of out-of-state firms. No person may practice accountancy in the state unless all partners are licensed Florida accountants. This law precludes the large national or international accounting firms from providing their services in the state, since the alternative to residence of all their partners is for each partner to take the accounting test, prerequisite for which are academic courses not given when many of the partners studied accounting.<sup>1</sup> Fortunately for the Alberta public, the provincial government has seen no need to create any such artificial barriers to competition in public accounting. As noted in the previous chapter on condition of entry, the provincial government specifically states in the Alberta Chartered Accountants Act that there is no legal restriction barring nonresidents from practicing public accounting in Alberta.

However, even though the provincial government may not want to have any restriction on outside competi-

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<sup>1</sup>. Jethro K. Lieberman, The Tyranny of the Experts, (New York: Walker Publishing Company, 1970), p. 148.





tion, it is quite possible for the accounting associations to erect certification barriers which could effectively reduce outside competition. As noted in an earlier chapter the right of firms or a lone practitioner to hold themselves out to the public as Chartered Accountants is of great advantage and it is possible that at some future date the right to the designation 'Accredited Public Accountant' may also prove advantageous. Since the admission qualifications of the two associations were discussed in the previous chapter, only those aspects which are pertinent to outside competition will be remarked on here. Looking first at Accredited Public Accountants, their admission requirements are such that non-residents of Alberta would have to qualify under subsection (b) of their admission qualification by-law since subsection (a) deals only with residents of the province. Thus a non-resident who aspired to be a member would have to show proof that he successfully passed the prescribed examinations of the council and either practiced public accounting full-time elsewhere for three years or had apprenticed under an approved accountant. This appears to be a low barrier to outside competition.

The Chartered Accountants, on the other hand, have three rules which apply to outside competition,



Rule 33 of their Code of Ethics, By-Law 38 (1c) and Section 15 (c) of the Alberta Chartered Accountants Act. Rule 33 was presented and discussed in the chapter on ownership and control; but as a brief review, the qualifications outlined in that Rule as essential for ownership of a firm practising as Chartered Accountants in Alberta are: Membership of at least one partner in the Alberta Institute, membership of all partners in the Canadian Institute of Chartered Accountants, and membership of all resident partners in the Alberta Institute. This rule creates no large entry barrier for Chartered Accountants residing outside Alberta. The fact that at least one partner of a firm needs to be a member of the Alberta Institute presents no difficulty since membership in the Alberta Institute does not require residency in Alberta and membership is easily attainable if one is a member of another provincial institute. However By-Law 38 (1c) does create a barrier to possible foreign competition. It is stated as below:

"38 (c) effective January 1, 1971 any member of a foreign accounting organization who wishes to become a member of the Institute shall, as a minimum, be required to:

- i) be a resident in Canada for a period of at least one year prior to admittance



- to membership and,
- ii) pass subject area examinations in Tax and Law or their equivalent".<sup>2</sup>.

It should be noted that these are only minimal requirements and such a person must also fulfill the other educational and non-educational requirements. The fulfillment of educational and non-educational requirements. The fulfillment of educational requirements may be very difficult for foreigners educated in countries other than United States or Britain because of the problems in evaluating the educational standards of these countries. However, assuming the foreign aspirant does fulfill all other requirements, the insistence on having these people prove their competence in Canadian Tax and Law by passing examinations, although it does create a barrier, seems quite practical and in keeping with other qualification standards set by the Institute. But part (i), which requires a minimum one year residency in Canada is surely an artificial barrier and serves no useful purpose to the public. It might first appear that this requirement was designed so that ownership of a Chartered Accounting firm could not be exclusively foreign, but this eventuality is covered by the fact that one

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<sup>2</sup>.The Institute of Chartered Accountants of Alberta, By-Laws, Sec. 38 (1c).





partner must be a member of the Alberta Institute and one of the membership admission qualifications stated in the Act is:

"15 (c) is either a Canadian Citizen or has filed a declaration of intention under the Canadian Citizenship Act."<sup>3</sup>.

Thus this restriction is not required for this purpose. Indeed it would appear that this restriction is only a penalty the foreigner must pay for not being Canadian. This is not in the public interest and does create at least a moderately high barrier for foreign competition especially if one considers the income which an otherwise fully qualified foreigner would have to forego during that year.

However, even the restriction on foreigners would be considered a low barrier overall and would have no effect on pricing decisions. Thus it can be said that public accounting in the province of Alberta, and subsequently in Lethbridge, have very low barriers to outside competition.

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<sup>3</sup>. Government of Alberta, The Alberta Chartered Accountants Act, Sec. 15 (c).



## PART II

### MARKET CONDUCT



The importance of the structure of a market lies in the way it induces firms to behave. Thus our attention is now turned to the market conduct of public accounting in Lethbridge. Market conduct refers to the patterns of behavior which firms use in adjusting to the market in which they sell (or buy) and encompasses two closely related aspects of behavior:

- (i) the process or mechanisms of interaction, cross-adaptation, and coordination of the policies of competing sellers (or buyers) in any market.
- (ii) the methods and aims which firms employ in establishing market policies determining selling prices, outputs, product designs and sales promotion outlays.<sup>1</sup>

Conceivably, the market aspects related to market conduct are alterable in short periods of time. Also, some patterns of conduct aim to change the elements of a market's structure; however, the patterns exhibited by firms in a market arise from the environment created by the market's structure. Thus the direction of causation is mainly from structure to conduct. But market conduct provides the link between a market's structure and the quality of its performance in the economy.

Market conduct is multi-dimensional, encompassing a number of important and subsidiary behavior aspects.

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<sup>1</sup> Bain, Industrial Organization, pp. 302-303.





But it would be highly unrewarding to investigate more than a few main aspects. In this section of study the examination of market conduct will be confined to:

(1) determination of fee levels, (2) determination of advertising and quality of service, (3) buyer conduct of firms.



## CHAPTER VI

### DETERMINATION OF FEE LEVELS

There are several important factors of market conduct that interrelate within the environment created by the market structure's determinants influence the public accountant's fee levels. The factors which will be examined in this chapter are:

- 1) The degree of market independence
- 2) The mechanisms facilitating inter-dependent coordination
- 3) The objectives and methods of fee setting

As in previous chapters, a review of the main theoretical possibilities will precede the analysis of public accounting in Lethbridge.

#### The Degree of Market Independence

To what extent are policy decisions of a firm in the market made independently or in isolation from those of other firms. The amount of interdependency between firms may be manifested by patterns of conduct varying across a wide spectrum of values between the opposing polar ends of complete independence and complete collusion. Although these patterns are a matter of degree, for the purpose of analysis four major patterns of coordination conduct will be identified.

(i) Complete Independence: This pattern of conduct is



associated with the economist's concept of "purely competitive market" and has two essential characteristics

- (a) each firm makes its price and output decisions unilaterally
- (b) and the individual firm takes no account of possible reactions of rivals to these decisions

For this to be a rational criterion for the firm's decision-making, its changes must have negligible effects on other firms of the industry.<sup>1</sup>

(ii) Complete Collusion: At the opposite end of the conduct spectrum in price determination is complete collusion. Collusion, in general, implies that firms collectively agree as to what prices to charge. For collusion to be complete three conditions must be fulfilled:

- (a) all sellers in the market must be parties to the agreement
- (b) all firms must rigorously adhere to the terms
- (c) and the agreement must include a clear mutual understanding which fixes prices

The agreement need not be written or orally expressed but rather may be a tacit agreement achieved by the rival firms' experiences with each other over time until an "unspoken understanding" occurs that all firms will act

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<sup>1</sup> Bain, Industrial Organization, pp. 306-307.





uniformly. This pattern of conduct provides the maximum opportunity for joint monopoly pricing in the market, although this need not occur.<sup>2</sup>

(iii) Incomplete Collusion: Between the extremes of complete independence and complete collusion are a large number of conduct patterns that embody elements of both collusion and independence. In this study, the term "incomplete collusion" is used to refer to patterns of conduct in which there is an agreement but for any one of a variety of reasons collusion is not complete. Some of these reasons are:

- (a) The agreement is not rigorously adhered to by some or all firms "Price-Shading" may occur from the uniform announced prices.
- (b) The terms of the agreement may be unclear thus may be interpreted differently by various firms.
- (c) Not all firms of the market are parties to the agreement. Thus some firms will be setting their policies independently.

With incomplete collusion, these divergences can occur alone or in combinations which cause departures from complete collusion.<sup>3</sup>

(iv) Interdependent Action Without Agreement: With this pattern of conduct there is no expressed or tacit agree-

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<sup>2</sup>. Ibid., pp. 307-308.

<sup>3</sup>. Ibid., pp. 308-309.



ment. Yet some or all firms, recognizing their mutual independence, unilaterally condition their decisions by taking into account the anticipated reactions of all or some of their rivals.<sup>4</sup>

As stated above, the patterns of coordinating conduct in markets are a matter of degree thus the variants identified are not mutually exclusive and any given conduct pattern may show elements of two or more of the categories identified. Each major type may have a wide range of subpatterns associated with it. Thus it becomes exceedingly difficult to distinguish between the patterns of coordinating conduct being employed. The analysis of the coordinating conduct pattern can be assisted by knowledge of mechanisms present in the market which could facilitate coordination.

#### Mechanisms Facilitating Interdependent Coordination

There are a near-endless number of means firms can use to facilitate coordination. In this section, only some of the more commonly-encountered forms will be examined.

- (i) Price Leadership: A common form of coordination is that of price leadership. With price leadership, price changes are usually announced by the industry's accepted leader and its initiative is followed by the

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<sup>4</sup>. Ibid., p. 369.



other firms. A wide variation is possible in the stability of the leader's position, the reasons for his acceptance as leader, and his influence over other firms. The simplest form of price leadership is the 'dominant firm leadership'. This type occurs when one firm literally dominates the market by controlling more than half the market's output and the rest of the market's firms are each too small to exert a perceptible influence through its decisions. A more complicated type of price leadership is "barometric price leadership". With this form of leadership the identity of the leader occasionally changes. Also the barometric price leader is not always followed, at least not immediately, presumably because it lacks the power to coerce others into accepting its pricing decisions. Furthermore, the barometric price leader may often exercise leadership only in a 'de jure' sense, making known through formal list price announcements changes which have already pervaded the market through informal departures from the list price, in the case of price decreases; or in case of price increases, formalizing 'de facto' conditions existing. Thus the leader-by lowering the list price when market conditions are depressed while raising it successfully only when demand and cost





conditions support the higher level -- merely acts as a barometer of market conditions. However, the barometric leader may exercise true leadership in effecting increases by taking the lead in creating higher price levels when producers in weaker market positions might be unable to increase prices successfully. Thus its leadership makes attainable prices higher than would have existed if no such firm existed. Price leadership may, of course, give the effect of complete collusion, or have very significant imperfections. Generally speaking, price leadership tends both to increase prices, on the average, and to reduce the magnitude of price fluctuations.<sup>5</sup>

- (ii) Implicit Bargaining: When interdependence is recognized by the sellers in a market, complete independence of action by the individual sellers can no longer be rationally expected. In this environment one form of coordination that can occur, without agreements or comparable devices being used by the interdependent sellers is known as 'implicit bargaining'. Without agreements. With this form of coordination, a firm makes a publically announced price change thereby implicitly making an offer to its rivals to

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<sup>5</sup> Scherer, Industrial Market Structure and Economic Performance, pp. 164-173.



react in some acceptable way, without making a direct communication. An unfavorable reaction by its rivals will cause the firm to withdraw from its announced position. In this manner an implicit bargaining process to fix a mutually acceptable selling price may automatically emerge. This process may culminate in a tacit agreement on price and thereby reduce the level of uncertainty among this market's sellers.<sup>6</sup>

(iii) Overt and Covert Agreements: The variety of these collusive agreements is limited only by the bounds of human ingenuity. Some may be casual and short-lived and others may be enduring and held together by elaborate organizational webs and binding written contracts. The most conspicuous form of coordination is a formal agreement among sellers to fix prices at specific levels. An excellent example of this is the International Air Transport Association, which not only fixes passenger fares on most of the international airline routes, but also includes in its agreements all aspects of the adjustments to be made for the various types of passenger service that the airlines may provide.<sup>7</sup> Where a

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<sup>6</sup>.Bain, op. cit., pp. 280-281.

<sup>7</sup>.Scherer, op. cit., p. 159.



formal agreement is impractical, emphasis is placed on securing mutual adherence to pricing formulas or lists of 'representative' price lists published by trade associations.<sup>8</sup>

(iv) Professional Associations: Perhaps the strongest influence and method of coordinating firms' market conduct is membership in a professional or semi-professional association. A person's membership in a professional association is contingent upon his adherence to the by-laws and Code of Ethics of the association. The rules governing the members' conduct may cover a wide range of activities and attitudes: the correct behavior to be observed towards clients and colleagues; the limits and rules of competition with others; remuneration and quality of service, and so on. Really, every aspect of the professional's work and bearing is bounded, more or less, by his membership in a particular association. Obviously, the more prestigious the association and the more advantageous it is to be a member, the more likely it will be that the association's rules of conduct will be more rigorous and more stringently enforced. A prime coordinating device of some

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<sup>8</sup>. Ibid., pp. 158-162.





professional associations, which is a variation of trade association's 'representative' price lists, is the issuance of a Schedule of Fees for the various types of services its members perform. This schedule may be issued merely as a 'guideline' for its members or issued as a 'minimum' fee schedule for each type of service performed, below which the practitioner must not charge. To do so would be a breach of ethics and make him liable to the association's disciplinary procedures.<sup>9</sup>.

#### Coordination and Interdependence of Public Accounting in Lethbridge

It is quite apparent that the major means of coordination in Lethbridge public accounting are the associations' regulations. Since there are two associations represented and number of independent firms, the coordination among firms with regards to conduct is divided. However there is a great similarity between the two associations' rules, especially regarding price; because, to a large extent, the Accredited Public Accountants regulations have been modeled after those of the Chartered Accountants. There may however be differences to the degree to which members of either association adhere to the regulations of their association.

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<sup>9</sup> Lieberman. The Tyranny of the Experts, p. 49.



Since the rules of both associations are similar, except where the two association's regulations differ completely, this study will only examine the regulations of the largest and most powerful association, the Chartered Accountants.

Unlike some other professional, provincial associations (for example, lawyers and dentists) the Institute of Chartered Accountants do not have a Schedule of Fees which compulsorily sets the minimum level of fees or which is to be used as a "Guideline". However, just recently the Institute has begun providing the results, to Chartered Accountants in public practice, of an annual voluntary questionnaire, which includes questions pertaining to the average hourly fee rates of firm members in different categories. The results broken down by the type of firm (national, local, etc.) and by general geographic area of firms -- Edmonton, Calgary, 3 other cities, other. They provide the average hourly fee rates prevailing in the geographical area for each type of firm as computed from the questionnaire's respondents. Although this information seems innocuous enough, and compared to the Schedule of Fees of other professional associations it certainly is; it may be detrimental to competition in the Lethbridge area. "Perfect information is unambiguously beneficial only in the context of purely



competitive markets. When the market is oligopolistic, it may impair rather than invigorate rivalry".<sup>10</sup>. There are very few Chartered Accountant firms in Lethbridge and, although Lethbridge fee data is mixed in with the data from two other smaller cities, the total number of firms in these three cities are small and to a large extent of the local type. Thus this information takes on more import to practitioners in Lethbridge than those in Edmonton or Calgary. This information can be used as a guide for firms' pricing policies and to some extent lessen the uncertainties of the market.

However, the questionnaire results must be considered only a very, very minor way in which the Institute coordinates and regulates price competition among its members. There are a number of rules in the Institute's Code of Ethics which control its members conduct in regard to fees. Rule 51 states:

"No practising member shall, in the course of his duties on behalf of a client, hold, receive, bargain for, become entitled to or acquire any fee, remuneration or benefit without his client's knowledge and consent."<sup>11</sup>.

This rule was incorporated to aid in maintaining the Chartered Accountant's independence. This rule attempts

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<sup>10</sup>. Scherer, op. cit., p. 449.

<sup>11</sup>. The Institute of Chartered Accountants of Alberta, Code of Ethics, Rule 51.







to ensure that the Chartered Accountant's opinion will not be biased by any financial considerations that he might have gained from the selected supplier, when providing a client with advice as to the type of equipment that the client should purchase or services he should acquire.

Another rule of the Institute which is meant to protect the Chartered Accountant's independence and perhaps also to protect the public against exorbitant fees states:

"No member shall offer or agree to render any professional service for a fee contingent on the results of such service, except in those cases where the amount of the fee is determined under a tariff prescribed in the legislation under which the engagement is carried out. He shall not profess that he does any service without fee except in the case of charitable, benevolent or other similar organizations."<sup>12</sup>.

The traditional justification of contingent fees is the obtaining of professional service by clients who otherwise could not afford it. Contingent fees are usually expressed in terms of a percentage of the amount which may be "saved" or "won" for the client. Not only could this create the possibility of an extremely high fee being levied; but, also there are a number of services that the

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<sup>12</sup>. Ibid., Rule 41.



Chartered Accountant provides where if his fee was contingent upon the results of his analysis, his opinions might be tempered, or suspected of being tempered, by financial considerations. Examples of this could be: the audit of financial statements of a company intending to issue securities to the public, with the auditor's fees contingent on the proceeds from the sale of the securities; or the engagement for cost analysis and suggestions on cost reductions, with the amount of fee to be a percentage of the savings the client might realize by adopting the accountant's recommendations. It should be noted however that nothing in this rule prevents the accountant from including the "benefits to the client" as a factor in the setting of his final fee.

However, the Institute's strongest rule regulating its members conduct in pricing states:

"No member practising as a public accountant shall be a party to any competitive bidding for professional appointments."<sup>13</sup>.

In a following guideline, it is expressed that the Institute opposes competitive bidding because "(it) .... lowers the dignity of the profession and is undesirable ... (a) may often result in the rendering of inadequate

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<sup>13</sup>. Ibid., Rule 35.



services to the public...."<sup>14</sup>. This rule, although it does not totally eliminate, severely limits price being used as a weapon of competition among members. The rationale for limiting price competition in this manner is that it reduces the temptation of practioners to lower their quality standards in order to offer a lower price and thereby attract clients -- i.e. it maintains the profession's standards. In fact, it would be argued, it may even encourage practioners to compete in quality thus may lead to the provision of better quality services than if this rule were eliminated.<sup>15</sup>. However limiting price competition may be detrimental for two reasons. First, price competition would seem likely to induce practioners to devote more attention to the improvement of efficiency which could reduce their costs and/or improve their service. Also, to the degree that there are economies of scale in public accounting, the limitation of price competition may hinder small firms in attracting the additional business necessary to achieve a more economic scale.<sup>16</sup>. Thus it is very doubtful whether this rule which severely limits price competition

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<sup>14</sup>. Ibid., Guideline 39.1.

<sup>15</sup>. Great Britain, Monopolies Commission, Command Paper No. 4463, Vol. I, p. 26.

<sup>16</sup>. Ibid., pp. 31-32.





is really in the public interest.

Thus having examined the rules which make the associations the major mechanism for facilitating coordination in Lethbridge public accounting, it remains to make a tentative identification of the pattern of coordination in the area. It would appear that there are elements of complete independence, incomplete collusion and interdependent action without agreement patterns involved in the market. Since there are a few large firms each having a significant share of the market, then each firm must necessarily take the reaction of the other major firms into account. However, since prices are not publically announced, the firms can act more independently. Yet the members of both associations generally adhere to the rules of their organizations thus on some matters are parties to an agreement. Finally, there are the independent firms which are small and are bound by no rules and therefore can act independently.

#### The Objectives and Methods of Price Calculation

The identification of the degree and type of seller coordination provides only a partial description of any given pattern of market conduct. The identification of the objectives and methods which the sellers apply in deciding the price levels for their services



provides a more complete and meaningful description of the conduct patterns.

By simplifying greatly for the purposes of analysis, the following general alternative goals or aims which firms seek to fulfill in determining prices can be discerned. They are:

(i) Independent Profit Maximization: With this as the aim of its pricing policies, the individual firm takes into account the effect that changes in its own prices will have on its profits. It anticipates that rival firms will not adjust instantaneously or fully match these adjustments. In its most extreme form this objective requires the assumption that the firm's adjustments will induce no rival reaction. In less extreme forms, the principle of independent profit maximization may occur if the firm simply disregards the probable reactions.<sup>17</sup>.

(ii) Joint Profit Maximization: This objective, agreed to by all firms in common, requires that the firms in the market adjust their prices to levels which will yield the largest aggregate present and future profits to all firms combined. The pursuit of this goal necessarily implies some form of coordination. If all sellers observed the principle, their joint

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<sup>17</sup>. Bain, op. cit., pp. 318-319.



actions would approximate the pricing behavior associated with pure monopoly. However the monopoly price level which would maximize immediate joint profits might not be reached if the market's barriers to entry were not high and the monopoly price level was such it produced profits that would attract new entrants. Instead the firms might prefer to maximize long-run joint profits by setting a price level which would not attract new entrants but still yield considerable profits. This variant of joint profit-maximization is a possibility when there are moderate or substantial barriers to entry. In cases where there are very low or exceedingly high barriers maximization of total profit with disregard for potential competitors will occur.<sup>18</sup>

- (iii) Mixed or Hybrid Profit Maximization: This principle contains elements of both joint and independent profit maximization of firms. Attempts at joint profit maximization are modified by attempts by various firms to enhance their own positions to the detriment of group profits. This mixture of aims occurs frequently when the cost function and/or

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<sup>18</sup>. Ibid., pp. 319-320.





market shares vary greatly within the industry. The myopic behavior of various firms interferes with the attempts of other firms to set prices high enough to achieve joint profit maximization. This hybrid principle normally leads to market prices which are lower than that of complete joint profit-maximization.<sup>19</sup>.

- (iv) "Fair Profit" Pricing Principle: Rather than attempting to maximize either joint or independent profits a firm or all firms in the market may be guided by the goal to earn a "satisfactory" or "fair" rate of profit. The pricing objective of a pre-determined target return on investment is an example of this aim. The specific content of this aim is ambiguous due to the fact that the words "fair" and "satisfactory" can not be uniquely defined but rather are subjective to the firm or industry involved.<sup>20</sup>.

The pricing objectives provide the framework within which actual pricing decisions take place and it is through the pricing methods employed that the prevailing aims of pricing are implemented. Again simplifying, the following general alternative pricing methods most often occur.

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<sup>19</sup>. Scherer, op. cit., pp. 135-142.

<sup>20</sup>. R. F. Lanzillotte, "Pricing Objectives of Large Corporations," American Economic Review, Dec. 1958, pp. 921-940.



(i) Marginal Pricing: This is the commonly referred-to technique in theoretical economics. By equating the marginal revenue derived from an additional unit of output to the marginal cost of that additional unit the firm can achieve its assumed overriding aim of profit-maximization. The marginal method of pricing would require some demand and costs forecasts and knowledge of their relative elasticities; however the difficulties involved with obtaining these estimates should not be overstressed because absolute accuracy can not be expected from any pricing method. Marginal pricing is a very flexible pricing method and is market-oriented.<sup>21</sup>

(ii) Full Cost or Cost Plus Pricing: An alternative to marginal pricing is full-cost pricing. There are a number of variants of this method of pricing with which a desired profit margin is added to estimated unit costs to calculate the product price. Two variations of this method are Fixed Margin and Variable Margin Pricing.

(a) Fixed Margin Pricing: Using this method sellers establish by adding an inflexible per-

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<sup>21</sup> L. Sonkodi, *Business and Prices*, (London: Routledge and Regan Paul (ed., 1969), pp. 29-34.



centage of profit to their unit costs; normally calculated on the assumption of a standard volume of output. This is a most rigid and mechanical method of pricing, totally disregarding market demand conditions; however it greatly simplifies the pricing problem and does facilitate coordination if desired.<sup>22</sup>.

- (b) Variable Margin Pricing: Using this method, sellers again follow a cost-plus-margin formula but vary the profit margin to take into account market conditions and other factors. This is a method which General Motors has employed with evident success for more than 40 years.<sup>23</sup>.

Unfortunately, the objectives of the firms' pricing policies can not be ascertained per se, from knowledge of the pricing methods used and it is quite possible using different methods to arrive at the same price level. However, the degree to which a firm's pricing aims will be met will be significantly influenced by the method used and knowledge of the methods employed can be used to infer the aims of the firms or help substantiate other evidence as to the firms' aims.

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<sup>22</sup>. Ibid., pp. 26-29.

<sup>23</sup>. Scherer, op. cit., p. 174.





The Pricing Methods and Objectives of Lethbridge Public Accountants

A series of questions were asked in Part B of the questionnaire for the purposes of ascertaining the methods, aims, and price levels of public accounting in Lethbridge. Question 14 and 15 were concerned with what effect the firms felt fee rate increases or decreases would have on the demand for their services. It is felt that from the results it is possible to infer the preceived relative elasticities of the demand for services of the various inter-association groups. The results are provided in Tables 6.1 and 6.2.

TABLE 6.1

THE DEMAND EFFECT OF A 25% FEE RATE INCREASE

Number of Clients Lost from Increased Rate	Chartered	Accredited	
	Accountants Percentage	Public Accountants Percentage	Independents Percentage
Many	-	33	40
Some	40	67	40
None or very few	60	-	20



TABLE 6.2

## THE DEMAND EFFECT OF A 25% FEE RATE DECREASE

Number of Clients Gained from Decreased Rate	Chartered Accountants	Accredited Public Accountants	Independents
	Percentage	Percentage	Percentage
Many	-	33	20
Some	40	50	60
None or very few	60	17	20

From the tables it can be seen that sixty per cent of the Chartered Accountant firms felt that an increase or decrease in their fee rates would have very little or no effect on the demand for their services. While the other forty per cent of the Chartered Accountant firms felt that these changes might result in the loss or gain of some clients, no firms thought the changes would have a large effect on demand. On the other hand, Accredited Public Accountant firms and independent firms generally felt that an increase in fee rates would result in loss which would vary between some and many clients. They also generally felt that a decrease in fee rates would result in a significant gain of clients, however it was felt that a decrease in fee rates would not have as large an effect as an increase.



This would indicate that Accredited Public Accountants and independent firms generally perceived their demand curve as being "kinked". However, more important, is the fact that Chartered Accountant firms perceive their demand curves to be more inelastic than the demand functions of Accredited Public Accountants and independents. That is, as a group, Chartered Accountants feel that fee rate changes will have less effect on the demand for their services than Accredited Public Accountants or independents generally do. This could be result of Chartered Accountants being more capable of achieving inter-association product differentiation or of the lack of public knowledge as to the fee rates of Chartered Accountant. But, regardless of the causes, the more inelastic a firm's demand curve is the less tendency it will have to become involved with price competition and the more inducement it has to raise its prices above the purely competitive level. Thus it can be inferred that Accredited Public Accountant and independent firms are more likely to be price competitive than are Chartered Accountant firms in the Lethbridge market.

Question 11 (a) was asked to ascertain the basis or method used by the firms in setting their fee





rates. Normally accountants establish their fee rates either on a "time spent" basis or on the "what the job is worth" basis. Using the "time spent" basis the firm will calculate the yearly relevant costs, such as overhead and salary costs, and divide this by the probable number of productive hours available during the year. This provides the accountant with the probable average hourly costs and to this amount he will add what he considers to an equitable profit margin. This figure is then the basic hourly rate for his services. Firms with members at different levels of competence normally have different basic rates for each level. It should be noted that this method of computation is a variation of Fixed Margin Pricing. A fee estimated on "what the job is worth" basis takes into account, in addition to time spent, the complexity of task, the clients ability to pay, the benefit to the client, and other factors. This method of fee computation is very similar to Variable Margin Pricing. The results of Question 11 (a) are provided in Table 6.3. Table 6.3 indicates that eighty per cent of the Chartered Accountants use the 'time spent' basis for setting fees most of the time. Whereas the other twenty per cent (one firm) use this basis most frequently. Accredited Public Accountants use the 'time spent' basis of fee setting



TABLE 6.3

## PERCENTAGE OF FEES SET ON A 'TIME SPENT' BASIS

% of Fees Set on a 'Time Spent' Basis	Chartered Accountants	Accredited Public Accountants	Independents
	Percentage	Percentage	Percentage
Almost all	-	-	20
75-95	80	50	20
55-74	20	33	20
Half	-	-	20
25-45	-	17	-
5-24	-	-	-
None or very little	-	-	20

less often than do Chartered Accountants with seventeen per cent using it less than half the time. The use of the 'time spent' basis of fee setting by independent accounting firms varies from twenty per cent of the firms who use it all the time to twenty per cent who never use it.

As stated before, from knowledge of the pricing methods used it is not possible to ascertain, per se, the aims of a firm's pricing objectives. However, since fixed margin pricing is the most non-competitive pricing method, the greater the use of this method the less



likely it is that the firm's aim is to achieve independent profit maximization. Thus it would appear that of the three groups, Chartered Accountants are the least likely to have as their pricing objective, independent profit-maximization. In fact, since this method requires that a fixed profit margin be applied as an element of the final hourly rate set, it is likely that this profit margin is derived from a pre-determined annual profit target. Thus it would appear that Chartered Accountants are the most likely to have as the aim of their pricing policies some 'satisfactory' profit level.

Question 11 (b) was directly concerned with the objectives of the firms' pricing policies. Firms were asked to select from the alternatives that were presented, the one which was the most important consideration in setting their fee. The results are presented in Table 6.4 below.

TABLE 6.4  
MOST IMPORTANT FEE SETTING CONSIDERATION

Most Important Consideration	Chartered Accountants Percentage	Accredited Public Accountants Percentage	Independents Percentage
Firm's View of Competitors Likely Charge	20	33	60
Firm's View of what the Client would be willing to pay	--	50	40
Provision of a reasonable level of Income for Partners	80	17	--





Each alternative provided to the firms is directly related to a theoretical pricing objective. The 'Firm's view of competitors likely charge' is associated with the objective of independent profit maximization. If all firms followed this objective, there would be a tendency for the fee rate level to be forced down to the purely competitive level. The 'firm's view of what the client would be willing to pay' alternative is linked to the pricing objective of joint profit maximization and the monopoly level of fee rates. If all firms had this aim then the fee rate levels would be at such levels that the largest excess profits possible would be made, at least in the short term. Finally, the 'provision of a reasonable level of income for partners' alternative is a variation of the "fair Profit" pricing principle. Since the words "reasonable" and "fair" are ambiguous, the exact fee rate levels which will evolve will be dependent on the firms' views of what these words mean. However it is most probable that these levels will be above the purely competitive level but probably much lower than the monopoly price level.

The results presented in Table 6.4 indicate that eighty per cent of the Chartered Accountant firms have 'satisficing' objectives for their pricing policies,



whereas twenty per cent aim for independent profit-maximization. This aim is consistent with their most used method of setting fees and their preceptions of their demand curves. On the other hand, Accredited Public Accountants and independent firms' pricing policies are mainly aimed at either independent profit maximization or at attaining a monopoly price level. Their more frequent use of a variable margin pricing method would appear to substantiate these aims. However, any attempts these firms wish to make to achieve price levels higher than the competitive level prevailing will be constrained by their competitive position and their preceptions of their demand curves. Thus it is likely that their fee rates are not much higher than the competitive level.

Finally, Questions 12 (a) to 12 (c) of the questionnaire asked the firms to state the average rate charged per hour for personnel in the various positions of the firms. Table 6.5 presents the results of these questions on an inter-association basis. Table 6.5 indicates the average hourly rate for partners or individual practitioners of Chartered Accountants firms is much higher than those of Accredited Public Accountant or independent firms, \$21.25 versus \$9.50 or \$9.00. How-



TABLE 6.5  
AVERAGE HOURLY FEE RATE OF PERSONNEL<sup>24</sup>

Average Fee per Hour for	Chartered Accountants <sup>1</sup> \$	Accredited Public Accountants \$	Independents \$
Partners or Individual Practitioners	21.15	9.50	9.00
Supervisors and Staff Accountants	11.25	-	- <sup>2</sup>
Accounting Students	7.75	-	-
Other Personnel	5.00	3.00	3.00

1. one firm was not prepared to disclose this information.

2. only one firm has staff accountants, therefore no figure will be provided.

ever it should be pointed out that most of the services provided a client by Chartered Accountant firms will be performed by less expensive members of the firms; whereas the Accredited Public Accountant or independent firms, usually practicing individually with no students and staff, would be charging the clients the high rate for

24. To attain a high response rate, the questions were presented in a manner that the firm had to only indicate the relevant dollar range of their various fee rates (see Questions 20-23 in Appendix I, Part B). Unless a more definite figure was provided in the follow-up interviews, the mid-point of the range was used as the firm's hourly charge for that type of personnel.





all of the time spent.. Thus it is quite possible that the final bill rendered to a client for a particular service would not be much larger from Chartered Accountant firms than from Accredited Public Accountant or independent firms. Also the final fee will be dependent on whether the firms charge the client for travelling time and other unproductive time periods or just for the time when work is actually being performed. But the firm's policy on this matter will probably be reflected in its fee rate levels, since the firm which charges only for productive hours must take this fact into consideration when deciding upon the number of income-producing hours it has available yearly. Thus the firm which charges clients only for productive time will likely have higher fee rates than others.

In summary, the main mechanisms of conduct coordination of public accounting in Lethbridge are the accounting associations. They have also influenced the conduct of most non-members. There are a diverse number of elements involved in the conduct pattern which has evolved. A major influence on these patterns has been fee rate secrecy which has caused the firms to act more independently. Lethbridge's Chartered Accountants, who perceive their demand functions as being



inelastic, have the best opportunity to achieve monopoly profit rates; yet their pricing policies are aimed at 'satisficing' objectives. However these objectives do not rule out the possibility that monopolistic profits are being made. Accredited Public Accountant and independent firms' pricing policies have as objectives both independent profit maximization and monopoly profit rates. However these firms perceive their demand curves as being more elastic thus are constrained to a large degree from setting fee rates which will provide profit levels much above the 'normal' competitive levels.



## CHAPTER VII

## DETERMINATION OF ADVERTISING AND QUALITY OF SERVICE

In the preceding chapter, the market conduct of firms as it concerns the pricing and coordination policies of these firms were discussed; however, there are also two other important aspects of market conduct of firms as sellers. These are their policies as to the quality of product they will provide and the sales-promotion policies they will employ. Presumably a firm's quality of service and advertising policies would be set so as to aid in the achievement of the same objectives as its pricing policy.

Since they are essentially multi-dimensional, the product quality and sales-promotion policies are generally far more complex than the pricing policies in an industry. In public accounting the complexity of these policies is greatly reduced because the accounting associations regulate, to various degrees, these aspects of market conduct: thereby limiting the alternative policies their members can follow. Borrowing the phraseology of fee rate determination, the pattern of coordination for these policies is essentially "incomplete collusion" with the accounting associations the main mechanisms for coordination. The accounting





associations set rules by which their members abide generally; but these rules are different for each accounting association. Independent firms can act as they wish, although normally their policies on these aspects have been influenced by the "atmosphere" of the market in which they serve. Thus instead of one agreement we can have two or three agreements to which not all members of the public accounting market are parties, i.e. -- incomplete collusion.

#### Quality of Service

If the measurement of quality for manufactured products is elusive<sup>1</sup>, then the measurement of quality in the field of personal service, where the practitioner's technical skill and judgment are the major ingredients, becomes exceedingly difficult. Yet, even if the quality can not be judged directly, it is possible to select certain criteria which can at least be used to infer the general level of quality. A possible list of such criteria for public accounting could be: association quality standards; formal education; formal accounting training; and degree of continued accounting development. It should be noted that an often used criterion, experience, has been left off this list. Experience as a

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<sup>1</sup>Richard E. Low, Modern Economic Organization, (Homewood, Ill.: Richard D. Irwin, Inc., 1970), pp. 218-220.



criterion for quality has a very nebulous value. Certainly experience is an aid to quality if the practitioner has been using high standards; but no amount of experience will aid the quality of service of a practitioner who has been using the wrong techniques or inferior standards. In fact, in this case experience might be deleterious to quality.

There are a number of ways that the accounting associations quality standards control the quality of service of their members. The first is by setting admission standards which will be discussed later when examining formal accounting training. A second means accounting associations have to regulating the quality of service of its members is to set out rules with which to control actual actions and procedures used by members when they provide service to clients. Independent accounting firms naturally can use their own discretion in these matters. Accredited Public Accountants are not much more limited since their rules provide only the vague guideline that members should "follow the generally accepted principles of accounting and maintain a high standard in the work they perform".<sup>2</sup> On the other, the Institute of Chartered Accountants provides its members with more precise rules and guidelines as to

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<sup>2</sup>. Association of Accredited Public Accountants of Alberta, Code of Ethics, Rule 12.



the standards they are to maintain. Rules 21 and 23 of the Institute's Code of Ethics state:

"No member shall express an opinion on financial statements examined by him, if he fails to obtain sufficient information to warrant an expression of opinion, or if his exceptions are sufficiently material to nullify the expression of an opinion."<sup>3</sup>

"No member or firm of which he is a partner, acting as a public accountant, shall express an opinion on the financial statements of any organization if the member, his partners, or his or their immediate families have any direct or indirect financial interest in the organization or such other interest as could influence the independence of the member or firm."<sup>4</sup>

The Institute provides a guideline for Rule 21 explaining what are the minimum standards which must be followed before the Chartered Accountant can claim that he has acquired "sufficient information". Guideline 21.1 is lengthy and detailed, and appears as Appendix 2 Schedule 2 of this study. In general it attempts to provide guidance on all aspects of the audit function: from who shall carry out the work to what type of opinion will be expressed in various situations. Rule 24 attempts to

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<sup>3</sup>. Institute of Chartered Accountants, Code of Ethics Rule 21.

<sup>4</sup>. Ibid., Rule 23.





ensure the maintenance of quality by prohibiting the member's provision of service in situations where there might be temptations to lower his normal quality standards.

A third method accounting associations have of regulating performance quality of their members is ensuring that members either comply with the association's minimum standards or face disciplinary action. The association can ascertain whether minimum standards are being followed by either of two methods. First the association can 'police' its members. That is the association can investigate the standards employed by a member firm upon complaint from a client. Both accounting associations in Lethbridge use this method; however the Chartered Accountant's Institute more rigidly enforce their rules. The second method that associations can ensure compliance to their minimum quality standards is to have an association investigator periodically inspect the working procedures of its members. At the present time neither accounting association employs this method, but in an interview with the secretary of the Institute of Chartered Accountants it was ascertained that the Council of the Institute has examined the practicalities of applying this method and now felt that after a transitional period, in which to educate



its members as to its benefits, this method will be adopted.<sup>5</sup> This method is currently being used by Quebec Chartered Accountants. Thus, using the accounting associations' quality standards as a criterion for the quality of service of practioners, it can be inferred that Chartered Accountants' services are of much higher standard because their association has higher admission standards, regulates the actual working procedures of its members more precisely, and 'policies' the compliance to its standards more rigorously.

A second criterion from which to infer quality is the level of formal education attained by practioners. Naturally there is not a perfect correlation between the quality of service a practioner will provide and the level of formal education he has attained. However, education does broaden the background from which a practioner can make his judgments. It increases his ability to communicate effectively. It enhances his ability to adapt to a changing environment and increases his ability to reason problems out logically. Further, it normally teaches people to organize their time and efforts more efficiently.

Questions 13 to 16 of the questionnaire asked public accounts about the level of formal education they

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<sup>5</sup>.Interview: Mr. V. Dzurko, Secretary of the Institute of Chartered Accountants of Alberta, Edmonton, Aug. 1971.



had attained. The results are provided in Table 7.1 on an inter-association basis.

TABLE 7.1  
FORMAL EDUCATION OF PUBLIC ACCOUNTS

Educational Level Attained	Chartered	Accredited	
	Accountants	Public	Independents
	Percentage	Percentage	Percentage
No Secondary Education	-	-	-
Some High School	-	67	67
Completed High School	45	33	33
Some University	30	-	-
Bachelor's Degree	15	-	-
Master's Degree	10	-	-

The results of Table 7.1 indicate that Chartered Accountants have generally a much higher level of formal education than do Accredited Public Accountants or independent accountants. The Chartered Accountants indicating that their highest level formal education was the achievement of a Bachelor degree also indicated that these degrees were in Commerce with accounting as a major. The ten per cent who indicated





they had attained Master's Degrees received them in Business Administration. There appears to be no difference in the Academic achievements of Accredited Public Accountants and independent accountants. Thus using education as a measurement of quality again the Chartered Accountants appear much superior whereas by this measure there would be no difference in the quality of service of Accredited Public Accountants and Independent accountants.

A third criterion from which to infer the general level of the quality of service provided by public accountants is the amount and complexity of the formal accounting training they have taken. There are two elements which can be considered part of formal accounting training: supervised practical training under guidance of a competent accountant, and more importantly, the learning of theoretical principles and abstract analytical tools. If the theoretical principles and the abstract analytical tools of accounting are not part of a practitioner's training then his potential growth of expertise in accounting will be diminished considerably, regardless of the amount of experience he gains over the years. Supervised training under the guidance of a competent accountant can provide the potential practitioner with insights into the numerous



practical problems which can occur and establish good working habits that will prove invaluable over the years. The value of this supervised practical training will be further enhanced if it occurs in an office practicing public accounting, for in this way the trainee will be exposed to problems from different areas of accounting and from clients in a variety of fields of endeavour.

Question 18 of the questionnaire asked public accountants the way they gained their practical experience in accounting prior to becoming a public accountant. Naturally, all Chartered Accountants answered that this experience was gained in the office of a public accountant since the Institute's By-Law 34 (1) states this is the only type of office in which an aspiring Chartered Accountant can receive his practical training. Of all the other public accountants only two stated that their experience was gained in the office of a public accountant: the rest stated their experience was gained in the employment of a business firm. The lack of exposure to various accounting systems and the various problem areas of public accounting in the years when these practitioners were first learning accounting is certain to be a severe handicap to overcome and detrimental to the quality of



service they can provide. Questions 19 to 21 then asked for information concerning the formal accounting courses that the public accountants had taken. The results indicated that no Accredited Public Accountant or independent accountant in Lethbridge had taken a formal accounting course or passed any accounting qualifying examinations. On the other hand, Chartered Accountant students must take a prescribed number of courses and pass a comprehensive final examination before qualifying as Chartered Accountants. Schedule A, Part II of the Institute's By-Laws outlines the subject area courses which its students must take and pass examinations in. There are sixteen courses: Economics, Management, Law, Quantitative Methods, Computing Science, Finance, Inductory Auditing, Introductory Management Accounting, Intermediate Accounting, Intermediate Auditing, Advanced Accounting, Advanced Management Accounting, Advanced Auditing, Tax, and Specialized Accounting.<sup>6</sup>

Thus the entire Chartered Accountancy course very comprehensively covers the academic subjects which are applicable to public accounting and provides Chartered Accountants with an excellent theoretical background. There-

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<sup>6</sup>.Institute of Chartered Accountants, By-Laws, Schedule A, Part 11.





fore, using formal accounting training as a measurement of the general standard of service provided, Chartered Accountants provide a vastly superior service; and again there is no discernable difference between the quality of service provided by Accredited Public Accountants and independent accountants.

A final criterion from which the quality of service can be implied is the time the public accountant spends in the continued development of accounting knowledge. The acquisition of competence does not end with the completion of formal training. Despite the patent difficulties in doing so in the contemporary world, the public accountant should attempt to keep current with developments occurring in his areas of service, so that his clients do not seriously suffer relative harm from his failure to do so. Two ways in which a public accountant can attempt to remain current is by reading accounting journals and participating in development or technical programmes, seminars, etc. Questions 34 to 37 of the questionnaire asked public accountants to indicate the extent of their reading of accounting journals. Question 33 asked the practitioner to indicate the total number of days in the last three years that he had spent participating in development



programmes. The results of these questions are provided in Tables 7.2 and 7.3 on an inter-association basis.

TABLE 7.2

## EXTENT OF READING OF ACCOUNTING JOURNALS

Frequency of Journal Reading	Chartered Accountants Percentage	Accredited Public Accountants Percentage	Independents Percentage
Never	-	33	50
Occasionally	30	67	33
Regularly	70	-	17
Prodigiously	-	-	-

TABLE 7.3

## PARTICIPATION IN DEVELOPMENT PROGRAMMES

Days Spent in Last 3 Years	Chartered Accountants Percentage	Accredited Public Accountants Percentage	Independents Percentage
None	10	67	66
1-4 days	25	33	17
5-10 days	30	-	-
10-15 days	10	-	-
15-20 days	10	-	-
Over 20 days	15	-	17



Table 7.3 indicates that seventy per cent of the Chartered Accountants read accounting journals regularly and the other 30 per cent read them occasionally; whereas no Accredited Public Accountant reads journals regularly and thirty-three per cent of these accountants never read journals. Independent accountants vary a little more with a full fifty per cent never reading journals and only seventeen per cent reading regularly. The extent to which Chartered Accountants participate in development programmes varies over the whole range of possible alternatives provided. Ten per cent have never participated in the last three years while fifteen percent spent more than twenty days. The largest number, thirty per cent, spent between five to ten days participating in development programmes. Sixty-seven per cent of the Accredited Public Accountants never participate and thirty-three per cent spent from one to five days in the last three years participating in development programmes. Likewise, sixty-six per cent of the independent accountants never participated, however 17 per cent (one accountant) spent more than twenty days in the last three years on development programmes. Thus using continuing development as an indicator of the quality of service provided to the public; again Chartered





Accountants' services stand out as superior with little difference between the other public accountant groups.

Overall, the indirect measurements of the general level of quality of service: association standards, formal education, formal training, and continued development, all indicate that Chartered Accountants provide a much superior quality. And since these elements combined must certainly have a synergistic effect then it can be inferred that the quality of service provided by the Chartered Accountant is vastly superior to other public accountants. Furthermore, using these criteria there appears to be little or no difference in Lethbridge. The intra-association quality differences among local accountant firms are likely to be of such a narrow range that these indirect measurements could not accurately discern them. Another regrettable feature of these measurements is that they do not give any indication as to the best value of the relative price-quality combination which occur in the market. The evaluation of the relative price-quality combinations which occur in the market is further complicated by the fact that the range of the services provided by a public accountant require different degrees of competence to ensure adequate performance. For



example, bookkeeping, in its narrowest meaning, can be performed correctly by a person with far less qualifications than a Chartered Accountant. Thus in attempting to ascertain the 'best value' in any given situation the public must not only consider the relative price-quality combination of the practitioner who will provide the service but also the degree of complexity of the service to be performed.

Yet how does all that has been stated here relate to the quality of service policies decisions of the individual firms? Simply because the public accountant must make the decisions of how much formal education to acquire, how much formal accounting training to obtain, how much continuing development to undertake, and which accounting association, if any, to acquire membership in. He makes these decisions, consciously or unconsciously, and the quality of his service is determined to a large extent by the choices he has made. For example, an independent public accountant practicing in Lethbridge could decide to undertake a certain amount of formal accounting training or he could decide to become a Chartered Accountant. Each of these alternatives has costs involved and the practitioner would have to make an investment to be able to provide higher



quality service in the future, just as a manufacturer can make an additional investment in better materials to produce a higher quality product. If the public accountant, after weighing the advantages and disadvantages of such alternatives, decides to instead continue practicing with his present qualifications he has made a quality policy decision and his performance will reflect this decision.

#### ADVERTISING

The second non-price market conduct dimension we shall examine is advertising. For the purposes of this study the word "advertising" is taken in its broadest sense, to include all those ways by which a practitioner is made publicly known in a manner which can be regarded as being for the purpose of obtaining clients or promoting his own professional image. Advertising can serve two purposes. Either it can be information in which case it aids in the elimination of ignorance of its audience; or it can be manipulative in which case its purpose is to sway the audience's opinion in favour of the product. Unfortunately it is exceedingly difficult to measure how much of any given advertisement is information or manipulative.<sup>7</sup> As stated at the begin-

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<sup>7</sup>Low, Modern Economic Organization, pp. 221-222.





ning of this chapter, this dimension of market conduct is also closely regulated by the accounting associations, but there are certain policy decisions which firms do make with regards to promotion. Thus, this section will first examine the advertising regulations of the associations, then discuss the arguments made for and against advertising restrictions, and finally review the promotional behavior of public accountants in Lethbridge.

Regulation of Advertising by Associations: Like most professional and quasi-professional associations, the tendency in accounting associations has been to prohibit advertising in its widest sense, subject to specified exceptions. This is in keeping with their dislike of any overtly competitive activities among members. So generally accepted has this ban on advertising become that most independent public accounting firms, although not all, refrain from such practices. Both Chartered Accountants and Accredited Public Accountants have rules in their Codes of Ethics which restrict advertising. But, as in other areas dealing with practitioner's conduct, the Accredited Public Accountants' rules pertaining to advertising restrictions have been patterned after those of the Chartered Accountants to such a degree that the presentation of both would be superfluous. Thus, in



this study only the rules regulating Chartered Accountants' promotional conduct will be examined.

The Institute of Chartered Accountants' Code of Ethics sets general rules that prohibit advertising and publicity; but with a series of supplementary rules and guidelines that specify permitted exceptions. Often these permitted exceptions are also strictly regulated as to form and content. The most general rule concerning promotional conduct states:

"No practising member shall adopt any method of obtaining or attracting clients which in the opinion of Council would tend to lower the standard of dignity of the profession".<sup>8</sup>

This is an encompassing rule which could be interpreted to also include price competition of any sort not specifically specified in other rules; however, as this rule's guideline, Guideline 36.1, points out, this rule is mainly to regulate the practitioner's conduct in regards to statements and talks to the news media. It points out that this rule does not prohibit activities which would provide favorable publicity to the Institute as a whole as long as statements made are responsible, in good

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<sup>8</sup>. Institute of Chartered Accountants, Code of Ethics, Rule 36.



taste, and reflect professional restrinat.<sup>9</sup> This general rule is then followed in the Institute's Code of Ethics by a more specific rule which also delineates the exceptions:

- "(a) Save as in these rules expressly provided, no member practising as a public accountant shall solicit clients by advertising.
- (b) No practising member or firm of which he is a member shall refer on his or their letterheads, nameplates, professional cards, or notices or in any other public way to any occupation other than one of "Chartered Accountant", "Management Consultant", "Trustee in Bankruptcy", "Data Processor", or such other activity as has been specifically approved by Council. Such member may use printed professional cards which do not tend to lower the standard of dignity of the profession, and may publish them in any publication which is open to all members. Such cards shall not contain more than the name of the member or firm, the names of the members who are partners of the firm and the business, telegraph and telephone addresses of the member or firm together with such other information as is permitted under this rule, except as provided in Rules 42, 43 and 44.
- (c) No member shall circulate copies of any publication containing his professional card or any other printed matter of publication containing his or his firm's professional announcements. However, a member or firm may publish or circulate by mail

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<sup>9</sup> Ibid., Guideline 36.1.





a professional card on the occasion of a change of address, change of telephone number, the opening of a new office or a change in partnership or name.

- (d) Members are permitted to place advertisements in newspapers and journals for staff for their professional practice and for their clients provided such advertisements conform to a high standard of professional good taste, are objective in nature and do not appear to be an attempt to bring the activities of the member or associated firm to the notice of the public.
- (e) A member shall not advertise for employment, either full-time or part-time, in such a manner as to indicate he is soliciting engagements as a public accountant."<sup>10</sup>.

To clarify section (b) of this rule, Rules 42, 43, and 44 restrict members who practice the activities of Management Consulting, Trustees in Bankruptcy, or Data Processing from using the designation of "Chartered Accountants" if these activities are a separate organization from the public accounting practice; or if these activities are carried on as department of the public accounting practice then any publication of firm bearing these designations must be kept separate from those bearing the designation "Chartered Accountants".<sup>11</sup> The Institute

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<sup>10</sup>. Ibid., Rule 37.

<sup>11</sup>. Ibid., Rules 42, 43, 44.



has provided the Chartered Accountant with numerous Guidelines to Rule 37 which are to provide guidance to the practitioner as to the form and content of exceptions to the general restriction on advertising. As an illustration of the degree to which the Institute regulates permitted advertising, the following is guidance for Business Cards on changes in partnership or firm name, or changes in address and commencement of practice:

"The size of announcement card is not specified in the rules but as the advertising done by members should be for the purpose of informing the public, not soliciting, good taste and a sense of responsibility are called for. In newspaper listings, cards should be kept to a maximum size of 2 newspaper columns wide by 3 inches deep.

Cards sent through the mail should be of no larger proportions than  $5\frac{1}{2}$  inches by  $4\frac{1}{2}$  inches. Listings which approach display advertising proportions do nothing for the reputation of the practitioners concerned or the profession".<sup>12</sup>.

As this guideline makes apparent, even the permitted advertising is fairly strictly regulated so as to ensure that it will serve only an informational function. However, no matter how restrictive the Institute's rules appear to be, there are promotional activities in which

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<sup>12</sup>. Ibid., Guideline 37.4.



the accounting firms are allowed to engage; such as the distribution by the firm of tax circulars and newsletters to its clients, luncheons with established and potential clients, and club memberships. It is in these areas where the individual firms make their promotional policy decisions.

The Arguments For and Against Advertising Restrictions:

A major reason for the Institute's restrictions on advertising and insistence on using methods of competition which maintain "the standard of dignity of the profession" is its belief that advertising would give a "commercial" image to the profession and "commercialism" would reduce the confidence of the public in the credibility of its members.<sup>13</sup> This may have been a valid argument at the turn of the century but in today's highly literate society this fear appears exaggerated. A second argument made for advertising restrictions is that the freedom to advertise might serve to entrench established firms more firmly to the disadvantage of the development of competition from new and smaller practices.<sup>14</sup> That is, if advertising were generally permitted, the larger,

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<sup>13</sup>. Since advertising prohibitions are traditional in professions, some occupations and associations use this restriction as a means of promoting recognition for professional status. This appears to be particularly applicable to Accredited Public Accountants.

<sup>14</sup>. John L. Carey and William O. Dorerty, Ethical Standards of the Accounting Profession, p. 47.





well-established firms could afford to advertise on a scale that would cause the new practitioner to be completely overshadowed. This is basically Bain's argument that advertising can create major barriers to entry,<sup>15</sup> but, as pointed out earlier in the chapter on conditions of entry, the inability to advertise also creates barriers to entry.<sup>16</sup> While this argument can not be firmly refuted it is doubtful whether public accounting, if freedom to advertise were permitted, would become a field for intensive advertising which would represent a significant proportion of total costs or involve large individual outlays, if only because they would be unacceptable by the public. Also this argument assumes complete freedom without any restraints, which need not necessarily be the case. A final argument made for the restriction of advertising involves the concepts of manipulative advertising, quality of service and consumers choice. This argument, presented in various ways, states that advertising restrictions offer some protection for the client from being induced to seek the services of a practitioner because of the effectiveness of an advertising campaign rather than on accountant's reputation

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<sup>15</sup>. Bain, op. cit., p. 282.

<sup>16</sup>. Supra, p.



and competence.<sup>17</sup> This is a very specious argument. Under the present advertising restrictions a majority of new clients are gained by recommendations and referrals from precisely those whom the accountants say are normally not technically competent to judge the quality of service provided. Also under the present restrictions, the promotional techniques of club memberships, luncheons, and public speechmaking take on added importance in gaining clients. Thus, in the absence of advertising -- where claims made will at least be open to challenge -- personal qualities of an accountant which are irrelevant to competent service are more likely to have an effect on the prospective client's choice of practitioner.<sup>18</sup> It is not always the biggest extrovert who is the most competent! Thus it becomes apparent that the arguments made in defence of the present degree of restriction on advertising have little substance. Also there are several arguments put forward as to why it would be in the public interest to remove most advertising restrictions. The first argument is that greater freedom to advertise would provide the highly qualified

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<sup>17</sup>. Lieberman, The Tyranny of the Experts, p. 81.

<sup>18</sup>. Great Britain, Monopolies Commission, Command Paper 4463, p. 65.



practioner the opportunity to tell the public why they could offer better service than the less qualified.<sup>19</sup>. This is particularly important in public accounting where different associations have different minimum competence standards. Also there are a number of ways in which greater freedom to advertise would have favorable effects in terms of efficiency. First, it might aid new entrants to build up their practices more quickly than is possible at the present by making the public aware of their existence. Second, costs might be reduced through advertising where it could stimulate demand for cheaper services of the routine kind. An excellent example of these efficiencys from advertising, which will be discussed later, occurs in Lethbridge. Third, greater freedom to advertise would probably cause the introduction of new methods and new kinds of service to quicken and be available at lower costs since the innovators of these developments would not be hampered in their efforts to make widely known the availability and possible merits of the services they can offer. Finally, the freedom to advertise might be expected to assist the more rapid expansion of the more

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<sup>19</sup>. Ibid., p. 62.





efficient practices at the expense of the less efficient.<sup>20</sup> All these developments would be in the public interest. Therefore, because the informational and efficiency benefits would outweigh any possible disadvantages accruing from advertising, accounting associations should be encouraged, in the public interest, to remove most of their restrictions on advertising - though certain restrictions on blatant misrepresentation would naturally have merit.

Sales-Promotional Conduct of Public Accountants in Lethbridge: The sales-promotion conduct of Chartered Accountant and Accredited Public Accountant firms are naturally constrained to those methods which are considered ethical by their respective associations. Moreover, most independent public accounting firms in the area also voluntarily refrain from advertising. The exception to this otherwise unanimous restrain on advertising is the independent international firm which specializes in the preparation of income tax returns. This firm advertises through all the various news medias and it provides the example that efficiencies can be gained through advertising.

Since this particular firm's promotional con-

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<sup>20</sup>. Ibid., p. 66.



duct is so unlike those of other firms, it shall be examined separately. This firm not only advertises in all media that it is in business to provide the specialized service of preparing income tax returns for its clients, it also informs the potential clients as to the minimum fee which will be charged. Thus its approach must be considered completely commercialized. Yet this firm, which only entered the market in 1965 now has the highest annual gross revenues of any non-Chartered Accountant firm in the area. So it appears that the public has some confidence in a commercialized public accounting firm. In an interview the manager of this firm stated that it was advertising which made possible the firm's rapid growth and low fee rates. He stated that a large volume of clients were required if the firm was to be successful charging its present fee rates and this number of clients could only be gained by stimulating the demand for this type of service. He further stated that seventy-five per cent of his new clients were persons who had never used the services of a public accountant before;<sup>21</sup> thus this firm's advertising had shifted the demand function for these services outward. Therefore, the sales promotion policies of this firm are to behave independently commercial with what appears to be the objective of aiding the achieve-

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<sup>21</sup>. This fact was verified in interviews with other public accounting firms, all of whom said that they had lost very few of their clients to this firm.



ment of independent profit-maximization.

The other public accounting firms which do not advertise commercially still have a number of means of promoting client relationships and gaining publicity for themselves. They can distribute accounting literature to clients, have luncheons with established and potential clients, have the firm's members join social clubs and pay for this membership, provide news releases on accounting matters which are of public interest, or make public speeches. In interviews with these firms it was ascertained that only Chartered Accountant firms distribute literature to clients, provide news releases, or make speeches. Further, it was learned from the answers to Question 70 of the questionnaire and follow-up interviews as was reported previously in the chapter on product differentiation<sup>22</sup>. that most non-Chartered Accountant firms spent less than fifty dollars on promotional activities annually. On the other hand, Chartered Accountant firms spend various amounts on these activities, with the largest amounts being spent by the largest firms; but in all cases the outlays for these activities represent less than one per cent of the firm's

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<sup>22</sup>. Supra, p.





annual gross revenues.

Thus the sales-promotion policies of nearly all public accountant firms in Lethbridge are for all intents and purposes identical. Either through associational coordination or voluntary acceptance of common market practices, these firms refrain from commercial advertising. Also, the firms keep expenditures on other possible methods of promotion to a minimum. Chartered Accountant firms do take advantage of non-expenditure forms of publicity, such as news releases and speeches; but the other public accountant firms do not. For these activities it is likely that the Chartered Accountants have more opportunities due to their higher prestige in the community. In total it can be said that, with the exception of the independent international firm, the sales-promotion policies of all public accounting firms in Lethbridge are "passive" and do not aid these firms in achieving their various profit objectives. Unfortunately, these policies are detrimental to public interest in that the gains in informational value and efficiency that are possible through alternative policies do not occur.



## CHAPTER VIII

## MARKET CONDUCT OF FIRMS ACTING AS BUYERS

In previous chapters in this part of the study, the market conduct of the firms has been examined as it pertains to their conduct as sellers in the market. This chapter will examine their conduct as buyers. In a large majority of markets this aspect of market conduct receives little attention since the buyer's role is considered to be passive in that "each buyer individually reacts to what is offered him without being able to make a policy regarding the price he pays, or perceptibly influencing it or the alternatives available to him".<sup>1</sup> However there are some markets, where the buying firms can play more active role. They can either influence or dominate the determination of prices at which they buy, by virtue of their monopolistic position as buyers. In public accounting, because the process of qualification for association membership requires apprenticeship, the associations' member firms achieve buyer market power with respect to their students. Since, in Lethbridge, only Chartered Accountant firms employ students, for the purposes of this

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<sup>1</sup> Bain, Industrial Organization, p. 365.



study, only the conduct of Chartered Accountant firms as buyers will be examined.

As with other aspects of conduct, the Chartered Accountant's conduct in regards to students is also regulated to a degree by the Institute's By-Laws and Code of Ethics. One way by which the Institute attempts regulate firms' conduct as buyers of student services is by providing rules as to the educational admission requirements of students who wish to become Chartered Accountants. As stated in the chapter on conditions of entry, By-Law 36 (1) (a) has set the minimum educational qualification for registration as a Chartered Accountant student after September 1, 1970 to be a baccalaureate degree. This rule prevents Chartered Accountant firms from offering interested persons with less educational qualifications employment as students in Chartered Accountancy. This educational requirement will also have ramifications as to the remuneration that firms will have to pay to individuals to attract them into studentship. The Institute also regulates firms' conduct by setting out minimum standards for offices employing Chartered Accountancy students in Schedule B of its By-Laws. This schedule appears in Appendix 2 of this study. Basically, this schedule sets out the minimum





requirements, with regards to such matters as: practitioner's experience; nature or comprehensiveness of the office's type of practice; location and design of the office; organization and office procedures used; and the clientele served; that an office must meet if it desires to employ registered students of the Institute. The Institute does investigate firms hiring students for the first time to ensure that these minimum standards are being met.<sup>2</sup> A further Institution restriction placed on offices which wish to employ Chartered Accountant students is that the total number of registered students can not exceed by more than three times the number of members in the office.<sup>3</sup>

The Institute also has rules which regulate the form, content, and distribution of recruitment brochures which firms may wish to use to attract students. Guideline 37.9 of the Institute's Code of Ethics states, in general, that recruitment brochures which a firm intends to distribute must be filed with the Institute prior to its use and it will be reviewed by the Institute. The brochure to pass the review must be factual, and be in good taste and show professional restraint. But it

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<sup>2</sup>. Interview: Mr. V. Dzurko, Secretary of Institute of Chartered Accountants of Alberta.

<sup>3</sup>. Institute of Chartered Accountants, By-Laws, Sections 36 (2) (3).



must not indicate the amount of salaries usually paid, or who the firm's clients are; nor can it be given to any individual who has not expressed an interest in employment with the firm, except when recruitment is to occur at an educational institution, in which case a supply of the brochures may be left at the placement office.<sup>4</sup> Although one of the reasons given for these rules is that it puts all firms on a more even basis when competing for students, the main rationale for this rule is found in the Institute's philosophy that advertising in general is unprofessional and when necessary must be restrained to ensure that the dignity of the profession is maintained.

Although the Institute regulates some of the conduct of firms when hiring students of Chartered Accountancy, it should be noted that it does not regulate the salaries these firms shall pay the students, nor does it prevent the firms from hiring students of other accounting associations.

#### Conduct as Buyers in Lethbridge

The Chartered Accountant firms in Lethbridge must naturally follow the Institute's rules of conduct for the employment of Chartered Accountant students; however there are a number of aspects of buyer's conduct not

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<sup>4</sup> Institute of Chartered Accountants, Code of Ethics, Guideline 37.9.



regulated by the Institute which permit the firms to use what buyer market power they have, and thereby allowing them to establish hiring policies that can aid in the achievement of their profit goals.

To ascertain what student education level was most practical for their market situation, firms were asked in Question 28 of the questionnaire what type of student they preferred to hire, taking salary costs into considerations. It should be noted that the question did not limit the firms to students of their own accounting organization. Table 8.1 provides the results of that question.

TABLE 8.1  
STUDENT EDUCATIONAL LEVEL PREFERENCE

Preferred Educational Level of Student	Percentage of Firms
High School Graduate	60
Bachelor Degree (Non-Commerce)	20
Commerce Graduate (Non-Accounting major)	-
Commerce Graduate - Accounting major	20*

\*the firm providing this answer also stated that 'dollar-wise' the high school graduate would be best; however there were other considerations.

Table 8.1 indicates that contrary to the new educational requirements imposed by the Institute the majority of





firms, sixty per cent, would still prefer to employ high school graduates. With this preference firms have naturally looked to substitutes for the student Chartered Accountant. A number of the firms now employ Registered Industrial Accountant students. This accounting association is considered high in the hierarchy of accounting associations, but its course is designed more to fill the needs for accountants in industry rather than public practice. Yet what appears to be important is that it still requires a student to have only a high school graduation qualification. In follow-up interviews all firms stated that, rather than hiring Chartered Accountant students, in the future they would be employing more RIA. students and other personnel who will be 'audit clerks' to carry out limited audit and accounting functions. These hiring policies have both advantages and disadvantages for the public interest. One obvious advantage is that if this work can be performed adequately by those less qualified than potential Chartered Accountants with Bachelor's degrees then the public interest is being served by having them do it and not wasting society's limited resources of highly trained personnel. Second, it may permit the Chartered Accountant firms to provide their services at lower fee rates than they would have done otherwise; although this



is not necessarily so. Yet there are some ways in which these hiring policies may be detrimental to the public interest. First, although these hiring policies are a competitive profit maximizing adjustment to a change in their market structure, the change in the education standards; they could, in the long run, also cause a change in the market structure by causing a fundamental change in the role of the Chartered Accountant. If similar hiring practices were to occur elsewhere it would serve to reduce the supply of Chartered Accountants throughout Canada. This shortage would elevate the Chartered Accountants to an elite position in public accounting acting in a more consultant role, with the ability to charge substantially higher fee rates. However, if these hiring practices were not to become prevalent elsewhere; then, because the market has low 'immediate' conditions of entry, any shortage of highly-qualified public accountants in the area caused by these hiring policies would not be a severe or prolonged problem.

Another problem with these hiring policies is that the personnel, who have been hired by these firms but have no hope of attaining neither Institute membership nor therefore partnership, will after a number of years set up their own practice in competition with their



former employers. This would seem advantageous to public interest except that the hiring firms can also anticipate these results and would soon urge the Institute to do everything in its power to persuade the government to bring in legislation which would restrict this competition.

Another aspect of the firms' conduct as it is related to hiring students or trainees which is not regulated by the Institute is the starting salaries which will be paid or the yearly salary increase they are to receive to compensate them for their probably increased productivity and value to the firm. Question 29 of the questionnaire asked firms to state the average starting salary which the firm would be willing to pay its 'preferred' student. Question 30 then asked firms to state, as a percentage of the average salary of a newly qualified graduate accountant, what was the average salary of students in different years of their training. The results of these two questions are provided in Tables 8.2 and Table 8.3 below. Table 8.2 indicates the main reason why the firms prefer high school graduates to university graduates. The average starting salary which would be given a high school graduate is \$250 whereas the average starting salary of a university graduate would be \$405. Both these average







TABLE 8.2

## AVERAGE STARTING SALARY FOR PREFERRED STUDENT

Education Level of Preferred Student*	Lowest Starting Salary	Highest Starting Salary	Average
High School Graduate	\$200	\$275	\$250
University Graduate	\$350	\$500	\$405

\*some firms provided data as to their average salaries for both categories.

TABLE 8.3

## AVERAGE SALARIES OF STUDENTS IN DIFFERENT YEARS TRAINING AS A PERCENTAGE OF A NEWLY QUALIFIED ACCOUNTANTS SALARY

Year of Training	Lowest Percentage	Highest Percentage	Average
4th Year Student	60%	80%	70%
3rd Year Student	40%	70%	56%
2nd Year Student	25%	55%	43%

starting salaries appear low relative to what these people could obtain in other lines of endeavour. The firms may be able to rationalize the lowness of university graduates starting salaries, to some degree, by that fact that



these students are in training to become Chartered Accountants and as in most professions should realize that they must forego some present potential income to attain the training that will allow them to achieve their goal. However, this line of reasoning cannot be applied to the low starting salaries of high school graduates who can not become Chartered Accountants. Any training given these students is no different than training given by any business firm to up-grade the competence of their personnel. In their case, perhaps because of their more limited alternative employment opportunities in this type of work, the firms appear to be able to suppress their starting salaries.

Table 8.3 indicates that, on an average, firms are willing to provide students with a yearly increase in salary of approximately thirteen per cent per year as they progress through their training and then provide a sizeable salary increase, thirty per cent, when the student becomes a fully qualified accountant. These yearly salary increases appear to be extremely reasonable but may be necessitated by the low starting salaries.

Overall, it does appear that the Chartered Accountant firms in Lethbridge market buyer power for the services of student or their substitutes is such that they



can use their hiring policies to aid in achieving the profit goals. They are switching to more non-Chartered Accountant student alternatives to keep their salary costs down and to a certain extent, they effectively suppress starting salaries.





### PART III

### MARKET PERFORMANCE



Analysis of the market structure and conduct of an industry aid in understanding the causality of the quality of an industry's performance. By market performance is meant the "strategic end results of market adjustments engaged in by sellers" serving as "the crucial indicator and measure of how well the market activity of enterprises contributes to the enhancement of general material welfare".<sup>1</sup> The evaluation of the market performance of an industry is an appraisal of that industry's effectiveness, as compared to accepted norms such as pure competition.

Market performance has several major dimensions. The dimensions which will be examined in this section are: (1) technical efficiency; (2) allocative efficiency and income levels; (3) size of selling costs; (4) product performance; and (5) progressiveness.

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<sup>1</sup>. Bain, Industrial Organization, p. 322.



## CHAPTER IX

## TECHNICAL EFFICIENCY

A dominant aspect of the performance of any industry is its relative technical efficiency in producing and distributing goods. This dimension of industry performance encompasses an appraisal of how closely an industry approaches the goal of supplying whatever output it produces at the lower attainable unit production costs. Bain has suggested that the technical efficiency of an industry is determined by:

- "1. The extent to which the firms in an industry and their plants attain or closely approach optimal scales or the proportion of industry output that is supplied by plants and firms of at least approximately optimal scale.
2. The extent to which these firms and their plants attain or closely approach optimal degrees of vertical intergration of successive processes or functions.
3. The extent to which the firms attain or closely approach the most efficient rates of utilization of their plant facilities--in effect, the extent, if any, of 'chronic' excess capacity in the industry."<sup>1</sup>.

Because of the nature of the service provided and the required inputs to obtain these outputs, even the least

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<sup>1</sup> Bain, Industrial Organization, p. 374.





degree of vertical integration is precluded in public accounting. Thus this study will discuss only the other two criteria of technical efficiency suggested by Bain.

EXTENT to WHICH OFFICES are of OPTIMAL SCALE

In general, regardless of the production process used or the resultant output, there are always economies to be gained by increasing the size of the productive facilities up to a certain point. This is because factors can usually be used in more efficient combinations. For example, the principle of the division of labour increases labour efficiency by permitting job specialization. But the point at which no further economies can be gained by increasing the production unit's size may vary greatly among industries, depending on the character of the production techniques used. The size of the production unit at the point where further gains in efficiency is called the "minimum optimal scale"<sup>2</sup> of the production facility of that industry. Thus, in any industry there may be production facilities that are (a) too small to gain all economies of scale possible, (b) the minimum optimal scale (c) bigger than necessary for efficiency though no less efficient than the minimum optimal scale because of its large size, (d) too large for efficient operation. To determine the minimum optimal scale of an industry the average unit

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<sup>2</sup>. Ibid., p. 167.



total cost curves of plants in the market must be ascertained. For public accounting, the best measured plant size is the number of personnel employed in the office. The ascertainment of the minimum optimal scale would allow the determination of the proportion of the total market output that can be supplied by that size office and this would be extremely significant in determining the minimum degree of seller concentration in public accounting which would be consistent with the attainment of technical efficiency. Also the measurement of the average unit total cost curves would permit the determination of the extent to which the production costs of sub-optimal scale firms exceed those of optimal scale firms. This is important since the industry's overall efficiency performance will be affected by both the number of offices below the minimum optimum scale and the extent to which costs are elevated when offices are of sub-optimal size. If the combined effect of these factors is small then the industry's overall performance would not be greatly impaired by the existence of sub-optimal scale offices.

It is widely recognized that where real output is estimated from labour input analysis of productivity, change is scarcely possible.<sup>3</sup> Thus for public

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<sup>3</sup>Victor R. Fuchs, and Jean A. Wilburn, Productivity Differences Within the Service Sector, Occasional Paper 102, (New York: National Bureau of Economic Research, 1967), p. 7.





accounting a measurement of the unit of output which is not based on the labour input is required. The "hours billed" per time period by a public accounting office is a measurement of output which is not directly dependent on the labour input. The average unit total cost curve for a public accounting office could then be approximated roughly by comparing the average total cost per hour billed of public accounting offices of various sizes.<sup>4</sup> Once the cost curve has been roughly ascertained, the minimum optimal scale in hours billed per time period can be established.

Once the size of the office of minimum scale has been established, then this size can be related to the total output of the market to determine the 'maximum' number of offices which is consistent with technical efficiency. Also the added production costs of offices at various sizes smaller than the minimum optimal scale can be ascertained and with this information plus the number of firms at these various sizes it would be possible to tentatively appraise the cost of the inefficiency in the market.

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<sup>4</sup> If the salaries of public accountants contain some element of monopoly rent then changes in market structure which served to reduce this element of monopoly rent would lower and change the shape of the cost curves estimated using this method.





Having suggested all of the above as to the possibilities of ascertaining the cost curves and methods of applying them, it is unfortunate that estimations of these cost curves or of the resulting size of the office staff of minimal optimal scale are not available for this study of public accounting in Lethbridge. As stated in the Introduction, the purpose of this study was twofold: (1) to provide a pilot study to assess methodology adaptation problems and develop an adequate questionnaire for a much larger research project to be conducted on the economic aspect of certain professions in Alberta; (2) to obtain an industrial analysis of public accounting in Lethbridge. Regrettably, the data obtained in the questionnaire and in interviews was inadequate for the purposes of constructing even very crude cost curves. Therefore, it is recommended that the questionnaire for additional research should include the following two questions.

1. Approximately, what was the total number of hours billed to clients by your office in the last year? (Include the booked chargeable time of all office personnel.)

\_\_\_\_\_ hours billed

2. In order to assess the general cost conditions of operating a public accounting office it is essential to ascertain a rather precise break-down of the various expenses incurred to provide this service.



Please, indicate the ANNUAL COST of each of the following items:

Fixed Costs (office rent,  
utilities, depreciation,  
insurance) \$ \_\_\_\_\_

Variable Costs (travel,  
office supplies, mis-  
cellaneous) \$ \_\_\_\_\_

Client Relationship costs  
(e.g. luncheons, news-  
letters, club member-  
ships). \$ \_\_\_\_\_

Training & Development Costs  
(excluding salaries) \$ \_\_\_\_\_

Salaries of: Partners or Owners \$ \_\_\_\_\_

: Other Staff  
Accountants \$ \_\_\_\_\_

: Students \$ \_\_\_\_\_

: Other Full-Time  
Personnel \$ \_\_\_\_\_

These two questions, in conjunction with questions already asked, will provide the information required to construct the cost curves and the second question should also aid in the analysis in other parts of the study.

Although no judgment can be made as to what is the office staff size of the minimal optimal scale or as to how much higher costs are for various sub-optimal size offices; there is an appealing reasonableness to the hypothesis that the sole practitioner has not exhausted



all economies to scale possible in public accounting. Partnerships, of whatever size, would permit the practitioners to spread out such fixed costs as necessary equipment and an up-to-date library over a greater potential output capacity. Also partnerships could result in more efficient utilization of both equipment and auxiliary personnel. Finally, partnerships would permit more specialization of tasks and more readily accessible peer consultation which should result in increased productivity. Thus, if these efficiencies can be gained, then approximately sixty-one per cent of all public accounting firms are providing their services to the market from facilities that are of a size which is, to some degree, sub-optimal with resultant higher production costs.

#### EXTENT OF CHRONIC EXCESS CAPACITY

The other aspect of the technical efficiency dimension of public accounting's performance that will be discussed in this study is the extent to which the total productive capacity of the industry is used. Of importance is whether there is either redundant capacity that raises costs above the minimum attainable level, or insufficient capacity that demand can only be met by utilizing it with uneconomically high intensity.





The fundamental definition of the "most efficient" capacity raises complex issues and is in some degree arbitrary.<sup>5</sup> Since this norm of efficient adjustment of capacity to market demand is interpreted differently, then naturally the definition used for excess capacity varies with different economists. John P. Miller asserts that excess capacity exists when:

"there is momentarily a greater willingness to supply product over a certain price range than there would be if time were allowed to make all equilibrium adjustments."<sup>6</sup>

On the other hand, Bain states that chronic excess capacity exists when:

"persistently, over a considerable period of time, there is a redundancy of non-obsolete capacity at times of high level or peak demand".<sup>7</sup>

Bain agrees that there is excess capacity, other than chronic, but argues that this sort of excess capacity is not necessarily inefficient.<sup>8</sup> Bain's definition,

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<sup>5</sup>. Bain, op. cit., p. 382.

<sup>6</sup>. Reed Moyer, Competition in the Midwestern Coal Industry, (Cambridge: Harvard University Press, 1964), p. 176.

<sup>7</sup>. Bain, op. cit., p. 384.

<sup>8</sup>. Ibid., p. 384.



as he admits, involves more redundant capacity in slack periods, with a probable increase of the average cost of supplying any given aggregate demand through time.<sup>9</sup>. Yet this definition deviates from the very meaning of technical efficiency. Thus for this study, excess capacity is defined as that capacity which is greater than the capacity that provides the lowest unit costs for the aggregate of output over all stages of the demand fluctuation.

Unlike those industries in which the supplier has considerable control over the rate of production, public accountants, because of the type of services they provide, are faced with a fluctuating seasonal demand for their services. Normally their peak demand period is from January 1 to April 30 because of personal income tax filing and because many firms still retain their year end in December. In the period from May 1 to December 30, the demand for services is not as great. The degree of seasonal fluctuation of demand for the services of the various public accounting firms will be dependent on the types of accounting service that the firms provide. For example, a firm which provides mainly personal income tax services will have large sea-

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<sup>9</sup>. Ibid., p. 382.



sonal fluctuations. These seasonal demand fluctuations can be a major factor in contributing to chronic excess capacity. If enough full-time personnel are hired to handle the demand for the peak period, then many of these personnel will be under-utilized during the slack period.

To ascertain the amount of excess capacity created by this seasonal demand in the Lethbridge market, Question 75 of the questionnaire asked the public accounting firms what percentage of the total monthly working hours of all full-time staff were not being utilized effectively during the period from May 1 to December 31. The results of the question are presented in Table 9.1 below: The table indicates that seasonal demand contributes to a fairly large amount of excess capacity in Lethbridge's public accounting. The unweighted average amount of excess capacity during the slack period for Chartered Accountant firms, using the mid-point of each of the ranges, is approximately 12.5 per cent: for Accredited public accountants 9.2 per cent: and for Independent firms 13.5 per cent. The lower excess capacity of Accredited public accountants during slack periods is indicative of the steadier volume of business they attain by providing mainly book-





TABLE 9.1  
PERCENTAGE OF STAFF UNDERUTILIZATION  
DURING SLACK PERIOD

Percentage of Under- utilization	Chartered Accountant Firms	Accredited Public Accountant Firms	Independent Firms
Less than 5%	-	1	-
5% to 9.9%	2	2	2
10% to 14.9%	1	3	1
15% to 19.9%	2	-	1
20% to 25 %	-	-	1
over 25 %	-	-	-

keeping services. The unweighted average excess capacity for all firms during the slack period is 11.6 per cent. However this method of computation underestimates the true excess capacity in the market caused by seasonal demand since firms vary greatly in size. A more accurate estimate of the excess capacity in the market can be obtained by weighting the reported underutilization of each firm by the number of employees of that firm. Table 9.2 presents the results of this method of computing the market's excess capacity in the slack period. The table indicates that the weighted average excess capacity of Chartered Accountants during the slack period is much higher than the unweighted



TABLE 9.2

THE WEIGHTED AVERAGE OF EXCESS CAPACITY  
OF THE ACCOUNTING ASSOCIATIONS

	Percentage
Chartered Accountants	15.8
Accredited Public Accountants	9.5
Independents	12.6

average whereas the averages for the other two types of accountants have remained relatively constant: this is because it is the Chartered Accountant firms which vary most in size and also because it was the two largest firms which reported the largest degree of underutilization of their staff during the slack period. Moreover, since employment is heavily concentrated in the Chartered Accountant firms, the weighted average excess capacity of the market during the slack period is 15 per cent. It should be noted that Bain would not consider this to be undesirable excess capacity since Bain feels that "it does not seem reasonable to charge with inefficiency an industry which has a capacity that is 'just about right' for meeting high-level demand and therefor has unutilized capacity."<sup>10</sup>.

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<sup>10</sup>. Ibid., p. 384.



Yet is this degree of an excess capacity in public accounting the inevitable outcome of the structural element of seasonal demand? Not necessarily, although it is highly probable that it could not completely be eliminated. There are a number of methods which public accounting firms can, and to some degree do, use to alleviate this situation. First, Public Accounting firms can persuade many of their business clients to shift year ends to the off-peak period. Second, they can use the slack period to complete interim audits leaving only a limited number of tasks for the year end. Third, Public Accounting firms can make better utilization of part-time personnel. It is possible that some of the gains in efficiency by employing part-time personnel would be offset by the commonly-believed lower productivity of part-time help. Also there may be very little possibility of obtaining part-time personnel for the more complicated aspects of accounting; however, for the more routine and clerical tasks, part-time personnel would be available and certainly the possibility of providing some training for the part-time help should not be ruled out. Finally firms should begin to employ the new auditing techniques, e.g. flow charting and statistical sampling, and endeavour to reduce the





amount of detailed audit work and thereby reduce personnel needs during peak periods. Naturally all of the above methods are now being employed to a certain extent; but the degree of excess capacity in Lethbridge's public accounting indicates that more intensive use is required.

#### TECHNICAL EFFICIENCY OF PUBLIC ACCOUNTING IN LETHBRIDGE

The difficulties created by insufficient data collection make an adequate assessment of the technical efficiency dimension of public accounting virtually impossible. The lack of data to construct cost curves made it impossible to even hazard a guess as to the degree to which accounting is characterized by the economies of large scale production. It was hypothesized that sole practitioner firms were of sub-optimal size and that this would create some degree of inefficiency in the market. A fairly substantial degree of excess capacity, 15 per cent during the slack period, was found to be prevalent in the market largely due to seasonal demand.

Although the information in this study on the market's performance in technical efficiency is weak and inconclusive, it would be beneficial to see what economic theory would have predicted regarding performance in this dimension. There are three principal theoretical hypothesis which bear on this issue.



1. "Industries to which entry is exceptionally easy are more likely to attract and maintain a substantial group of inefficiently small plants and firms than industries to which entry is more difficult."<sup>11</sup>.
2. "Strong product differentiation within an industry leads to the existence and survival of a comparatively larger fringe of inefficiently small plants and firms, whereas slight (or no) product differentiation is conclusive to a comparatively smaller fringe."<sup>12</sup>.
3. "Excess capacity is most likely to occur in industries with perceptible but relatively low barriers to entry, provided that the established sellers develop enough concentration to make oligopolistic price-raising feasible."<sup>13</sup>.

In the analysis of the market structure of public accounting it was found that although certification created a large barrier for those aspiring to be Chartered Accountants, the overall barriers to entry were very low.<sup>14</sup> It was also found that there was strong inter-association product differentiation but relatively weak intra-association differentiation.<sup>15</sup> It was also found that the market was very highly concentrated.<sup>16</sup>

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<sup>11</sup>. Ibid., p. 434.

<sup>12</sup>. Ibid., p. 436.

<sup>13</sup>. Ibid., p. 437.

<sup>14</sup>. Supra, p. 60

<sup>15</sup>. Supra, p. 46

<sup>16</sup>. Supra, p. 36



Given these findings, it could tentatively be predicted that there would be a substantial group of inefficient non-Chartered Accountant firms in the Lethbridge market and that excess capacity would likely occur. Thus, although the analysis of this dimension of industry's performance was very inadequate, the conclusions which were drawn appear to be consistent with predictive results.





## CHAPTER X

## INCOME LEVELS AND ALLOCATIVE EFFICIENCY

In this chapter the market performance of public accountants will be examined using two related perspectives: the profit rates which accrue to firms; and the income levels of practitioners. The basic question is whether or not public accountants receive an element of monopoly rent as part of their income. Again, unfortunately, lack of data will permit only a discussion of the techniques that can be employed in any continuing research which would permit any conclusions to be made on these elements. In the first section a method will be proposed which will allow the evaluation of the size of the actual price-cost margins of each firm and thereby their profit rates. This analysis would be similar to the usual method of evaluating allocative efficiency. The second section will discuss the return on human investment as it applies to public accountants.

## ALLOCATIVE EFFICIENCY

Allocation is concerned with the apportionment of resources among the various industries in the economy. Allocative efficiency is "the degree at which present



allocation approaches the 'best' allocation for maximizing output, given the present technology."<sup>1</sup> This should occur if "resources are allocated among the production in such a way that the marginal product of each resource was the same in every line of production."<sup>2</sup> The allocative efficiency attained by an industry can be judged by the relationship between its selling price and the marginal costs of production which results from the rate of output it produces -- particularly in the long run. Overall, allocative efficiency is lessened to the extent that an industry's output is smaller, so that its price exceeds its long-run marginal cost, or is greater, so that its price is less than its long-run marginal cost. Since the long-run average cost of production is about the same as the long-run marginal costs, allocative efficiency is best judged in practice by the relationship between its selling price and its long-run average costs."<sup>3</sup>

If selling prices are greater than costs then the industry or firm is achieving excess profits. Excess profits, defined economically, mean "the residual excess, received by or for a firm's owners, of the sales revenue of the firm over the costs incurred to earn the

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<sup>1</sup>. Stern and Grabner, Competition in the Marketplace, p. 52.

<sup>2</sup>. Bain, Industrial Organization, p. 24.

<sup>3</sup>. Ibid., p. 375.



revenue."<sup>4</sup> The cost incurred includes "the 'imputed costs' equal to the values (in the best alternative market) of such goods and services that are supplied directly by the firm's owners rather than bought from others."<sup>5</sup>

The excess profits of a firm can be simply expressed by formula:

$$R - C - D - i \cdot V = \text{EXCESS PROFITS} \quad 6.$$

where R represents annual revenues, C represents current costs, D represents depreciation and amortization of past costs allocable to current revenues, i represents the net interest rate (net of 'risk' returns), and V represents the value of the owner's investment. It should be noted that D would have to be adjusted for price level changes which have occurred since assets were purchased or excess profits would be inflated by increases in the price levels. Normally, profit data is expressed as ratios or "rates on" certain related magnitudes. This is especially useful for comparisons between different firms or industries. The most convenient ratio from available statistics is the ratio of excess profits to owners' investment. Expressed as:

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<sup>4</sup>. Ibid., p. 387.

<sup>5</sup>. Ibid., p. 387.

<sup>6</sup>. Ibid., p. 388.





$$\frac{R-C-D-i \cdot V}{V} = \text{EXCESS PROFIT RATE ON EQUITY} \quad 7.$$

This is a useful ratio because the incidence excess profits can be quickly determined from financial records. If the accounting profit rate on equity ( $\frac{R-C-D}{V}$ ) equals the applicable market interest rate then price equals average cost and no excess profits are reaped. If the accounting profit on equity is higher, then price is greater than average costs and there are excess profits: if it is less than the applicable rate then price is less than average costs and there is a net loss.

Unfortunately most public accounting firms, not being limited companies, do not publish financial statements. However, the firms' relative price-average cost relationships can be derived using questions from the questionnaire and those proposed in the preceding chapter on technical efficiency. Also, since fixed costs are relatively insignificant, it can be expected that there will be a reasonably quick adjustment to the long-run equilibrium position thus current data may be used to approximate long run data. The average price can be calculated by dividing the firm's gross fees (question 5) by the total hours billed (proposed question

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<sup>7</sup>. Ibid., p. 391.



1). The average costs per unit can be calculated in a similar manner from data received from proposed question 2; however, only after this data has been adjusted to ensure that excess profits are not already being included. The total costs of the firm which can be computed from the proposed question 2 includes the incomes of owners. Normally, the incomes that partners would derive from a practice would be percentages of the profits and the sum of their income would equal the entire profit. Thus, total costs calculated in this manner must naturally equal gross revenue; therefore, price would equal the average cost per unit and there could not be any excess profits. Therefore, the income to owners must be removed from total costs and some 'imputed' value assigned to their services which would then be added back to the costs. The question then becomes what are the correct 'imputed' values to assign to their services? In the definition above, it is stated that this amount should be the value that could be obtained in the best alternative market. A possible alternative market for their skills is in accounting positions outside public accounting, most likely as a chief accountant of a firm. The Alberta Bureau of Statistics annually publishes a Salary and Wage Rate Survey and



provides definitions for personnel positions as well as information on the range and weighted average of salaries for these positions. A Chief Accountant is defined as a person who:

"Directs an advanced and extensive programme that requires solution of difficult accounting problems. Consults with the senior officials and plans the accounting procedures necessary to achieve objectives. Supervises an accounting division which consists of professional and clerical subordinates. Extensive experience and professional accounting qualifications are required." <sup>8</sup>.

Thus this position appears to be a very suitable alternative for the services of a partner in a Chartered Accountant firm. Other positions are defined which could be applicable to owners of Non-Chartered Accountant firms. Similar adjustments could be made for the staff accountants of Chartered Accountant firms if it was felt that their salaries contained an element of monopoly rent which would disguise excess profit. If after these adjustments it was found the firm's price was greater than the average costs, this would indicate excess profits were accruing to the firm. If this was

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<sup>8</sup>. Government of Alberta, Fourteenth Annual Report, Alberta Salary and Wage Rate Survey, (Edmonton: Queen's Printer, 1970), p. 25.







so for all firms, or all firms of any given association, it would be a signal that allocative efficiency could be increased by more accountants entering public practise. The findings here might also lend supportive evidence to the analysis of returns to human investment in public accounting.

#### INCOME LEVELS OF PUBLIC ACCOUNTANTS

An alternative approach to this dimension of performance is via an examination of the income levels of public accountants. The main concern is whether barriers to entry into the profession cause an element of monopoly rent to become part of the public accountant's income. A method of testing whether a sizable element is present in their income is to calculate the internal rate of return on the investment made in gaining admission. If the rate of return is excessively high then an element of monopoly rent can be said to be present. Because all other public accountants in Lethbridge were found to have no formal accounting education, attention will be centered on the Chartered Accountants. Again lack of data necessitates only a discussion of the methodology which could be used in a subsequent study and a review of the relevant costs involved in the training to become a Chartered Accountant.



It should be noted at this time that an attempt was made to gather the necessary information for this analysis by asking accountants to provide their personal annual income.<sup>9</sup> To obtain a good response to this question, income ranges were provided. But still the response was not very high, approximately sixty per cent, with many of the Chartered Accountants declining to answer. This fact plus the income ranges used with such a small population made the information gained insufficient to provide meaningful results.

THE RATE OF RETURN ON CHARTERED ACCOUNTING TRAINING MODEL:

The model which will be employed was developed by G. S. Becker.<sup>10</sup> This model can also be used to evaluate the increase in the costs to become a Chartered Accountant caused by the recent upgrading in educational qualification standards. The model is as follows:

- C = the total investment in training
- C<sub>j</sub> = investment made in year j
- X<sub>j</sub> = the after-tax net earnings in year j of a high school graduate
- Y<sub>j</sub> = the after-tax net earnings in year j of a Chartered Accountant in public practise
- r = the internal rate of return

Then, assuming there has been no further investment in training of the high school graduate, the amount invested

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<sup>9</sup> See question 38 of the questionnaire.

<sup>10</sup> G. S. Becker, Human Capital. A Theoretical and Empirical Analysis, With Special Reference to Education, (New York: Columbia University Press, 1964), pp. 37-49.



in Y during any period would be defined by:

$$C_j = X_j - Y_j + r \sum_{k=0}^{j-1} C_k, \text{ all } j \quad (1)$$

and total costs by:

$$C = \sum_{j=0}^{\infty} C_j \quad (2) \quad 11.$$

Providing the net earning streams of both X and Y are known, then the costs and returns can be estimated from equation (2) even when there is no simple investment period.

Applying the general formulae to the case of Chartered Accountancy, upon entering training the Chartered Accountant at a particular year, called year 0, begins receiving an after-tax net earning stream of  $Y_0, Y_1, \dots, Y_n$  through his career in public practise. The after-tax net earnings stream is used because we wish to ascertain the private return on training investment. "Net" earnings mean "gross" earnings during the year minus any private costs associated with gaining this training and any other costs thereafter required to earn this income stream. For example, once a person has become a Chartered Accountant, he must pay yearly

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<sup>12</sup>. Ibid., pp. 38-39.





membership dues to the Provincial Institute. This would be deducted from gross earnings, however for Chartered Accountants this is an insignificant amount. The private costs of Chartered Accounting training will be investigated more fully later.  $X_0, X_1, \dots, X_n$  represents the net earning stream of a high school graduate who begins working at year 0 and is the same age as the Chartered Accountant trainee. A high school graduate was chosen because until last year, this was the education qualification standard required of a Chartered Accountant student. "The cost of investing in human capital equals the net earnings foregone by choosing to invest rather than choosing an activity requiring no investment."<sup>12</sup>. Thus, if the investment in Y were for only one year and X requires no investment, then the cost of training would be simply the difference between the two activities -- i.e.  $C = X_0 - Y_1$ . Because, as long as the initial investment yielded a positive return, a person who invested in the initial period could receive more than  $X_1$ , in period 1; therefore, the earnings foregone are greater than  $(X_1 - Y_1)$ . Thus, Becker's general formula

$$C_j = X_j - Y_j + r \sum_{k=0}^{j-1} C_k, \text{ all } j \quad (1)$$

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<sup>12</sup>. Ibid., pp. 38-39.



states that the investment in year  $j$  is equal to the difference in net earnings of  $X$  and  $Y$  in year  $j$  plus the interest income accruing on all prior investments. The total costs of training would be the sum of all yearly costs during the investment period which can be defined as all periods in which the earnings of  $Y$  are below the sum of those of  $X$  and the income accruing on prior investments. The internal rate of return or the return on the investment is the rate of discount which equates the present values of  $X$  and  $Y$ .

In any further study income data for a particular year for different age and experience cohorts can hopefully be obtained using confidential questionnaires. The other income data required should be available from Personal Income Statistics published by the government.

PRIVATE COSTS OF CHARTERED ACCOUNTANT TRAINING: There are a number of private costs which the Chartered Accountant student must deduct from his gross after-tax earnings to get his net earnings. These costs will vary somewhat depending on the method which the student employed to become a Chartered Accountant. For simplicity's sake only two routes will be explored. First, the student could have enrolled upon completion of high school and served five years as a trainee in a Chartered



Accountant's office taking the necessary courses and examinations in that time; or second, the student could have enrolled after obtaining his Bachelor of Commerce degree, having an Accounting major, in which case he would have to serve two years in the office. He would be exempt from taking twelve courses and examinations. These two patterns would have different private costs associated with them. For the high school graduate, the heaviest investment could possibly be the cost of taking the Institute's courses. It is possible that the firm would pay for these courses. Some firms do; however, the cost of the courses would then probably be reflected in lower gross earnings for the student. But it still would be necessary to obtain data on students salaries net of course fees. This information cannot be obtained from the present questionnaire; therefore, a question asking the firm whether or not they pay for the courses of their students should be included in the questionnaire used in any later study. The high school graduate would be required to purchase the necessary text and lesson notes for the courses. He will also have to pay a registration fee of ten dollars to become a student and annual membership dues of twenty dollars a year. Finally, he will have to pay examination fees for all





courses which he takes. On the other hand, the University graduate students will avoid most of the expense of the Institute's courses and examination fees; but he will have the added investment of the costs of attending university. Also, unlike the high school graduate student, who at least earns small income from the firm, the university graduate student will likely not earn any salary while attending university; although he may take summer employment. The major university expenses he will encounter are tuition fees, required texts, and school supplies. He will also have to pay the registration fee to become a Chartered Accountant student and annual membership dues for two years. Finally, students from both patterns will have to pay a membership admission fee of one hundred and fifty dollars when they finish their studentship.

CHANGE IN FINANCIAL BARRIERS OF ENTRY: As stated earlier in the chapter on barriers to entry, in 1970 the Institute of Chartered Accountants raised its minimum educational qualification standards for students from high school graduation to a bachelor's degree. Using Becker's general formula, the degree by which the financial barriers of entry have changed can be ascertained by computing the total cost of each alternative studentship



pattern and then compare them. It is quite probable that the raising of the minimum educational standard substantially increased the financial barriers of admission.

THE DISCOUNT RATES PROBLEM: Having computed the rate of return for this training investment, the problem still remains of how to interpret it. What rate should be considered 'proper' and how high must the rate of return be before it should be considered excessive. Unfortunately, there is not even an agreed upon rate of discount for education in general. Becker has made use of a comparative rate of return of about nine to ten per cent, on the grounds that this is roughly the average rate of return on private investment in the United States.<sup>13</sup> If this guideline is used for education in general, it seems logical then that the "proper" rate for Chartered Accountants should be at least slightly higher to reflect the specialization which is involved and the high failure rate, both of which are risks that require compensation.

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<sup>13</sup>W. G. Bowen, "Assessing the Economic Contribution of Education, in Economics of Education, ed. by M. Blaug, (Baltimore: Penguin Press Ltd., 1968), p. 91.



## CHAPTER XI

## MARKET PERFORMANCE IN OTHER DIMENSIONS

There are several other dimensions of market performance which are useful to examine when evaluating the performance of public accounting in Lethbridge. These are: size of selling costs; product performance; and progressiveness.

SIZE OF SELLING COSTS

The standard used to appraise the market performance of the magnitude of costs incurred for sales promotion is that these costs be incurred only to the extent that they are performing an informational function and are essential to the effective working of the market system.<sup>1</sup> Expenditures in excess of this "base" level are viewed by most economists as involving uses of society's resources which do not provide offsetting benefits, and are therefore undesirable. To the extent that the firms' selling costs fail to expand the total demand for an industry's output and merely result in shifting demand among firms in the industry, the costs of the industry are raised. Increases in costs which do not increase industry output are considered "wasteful".

Normally, the concern of economists has been

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<sup>1</sup> Bain, Industrial Organization, p. 413.





centered on excessive sales promotion costs. But excessively low selling costs could also be inefficient; and thus represent poor performance in this dimension. As was noted in an earlier chapter, but for the exception of one firm, all public accounting firms in Lethbridge spend much less than one per cent of their sales revenue on advertising with non-Chartered Accountants firms spending virtually nothing. Moreover, these expenditures are made almost entirely in ways other than direct advertising to the public. These 'subtle' methods may in themselves indicate a degree of inefficiency since they may not be as effective in stimulating demand as direct advertising. But also, as the one firm which does extensive advertising has proved, the demand for at least some of the services of the public accountants can be increased by more extensive advertising; therefore advertising would be beneficial and, depending upon the shape of average total cost curves, could possibly even lower costs in the market through an increased volume of output. Finally, as was pointed out in the chapter on advertising, increased advertising could improve efficiency by facilitating the growth of new entrants, provide an incentive to innovators, and assist the expansion of the most efficient firms at the expense of others. Thus



it can be concluded that in this dimension the market performance of public accounting in Lethbridge is poor.

#### PRODUCT PERFORMANCE

When evaluating the product performance of an industry the general concern is normally with:

"how well the firms engaged design, determine the quality of, vary, differentiate and progressively improve their products--all relative to that performance in these several regards which would achieve the best attainable balance between buyer satisfaction and the cost of production."<sup>2</sup>.

The determination of the general level of quality of the product offered by the firms in a market is approximately viewed as a selection among available alternative product quality-price combinations. Given these alternative combinations, the theoretical criterion of ideal product performance is "firms should elevate quality (starting at some minimum base level) so long as the resulting addition to buyer satisfaction outweighs the resulting addition to cost of production ...."<sup>3</sup>. Unfortunately, this criterion is difficult to apply in the real world; since, not only would the data on costs required for evaluation be complex and practically unobtainable; but the measurement of the buyer-

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<sup>2</sup>. Ibid., p. 421.

<sup>3</sup>. Ibid., p. 422.



satisfaction associated with each alternative would also prove nearly futile. Thus, there is no meaningful way to evaluate whether the quality-price combinations selected by public accountants in Lethbridge are optimal. However, the gap between the potential quality of service which can be provided and that which is actually provided will increasingly widen for services that require intellectual knowledge, unless the practitioner constantly updates his knowledge. If continuous updating of knowledge can be interpreted as beneficial product improvement, then in this aspect of product performance the Chartered Accountants in Lethbridge perform very well overall; whereas the other public accountants perform poorly. Another criterion by which to evaluate the product performance of an industry is the variety of the quality-price alternatives offered by firms in any particular industry. The theoretical ideal product performance with this criterion is:

"the overall satisfaction of buyers will be best served, other things being equal, if the sellers of the industry provide a variety of product - price alternatives equal to the variety of buyer tastes in this regard, with each of the several alternatives offered being optimal for the particular group of buyers it serves...(unless) in the interests of efficient production, and







on balance desirable from the standpoint of buyer welfare, it is necessary to restrict variety below just indicated."<sup>4</sup>.

Using this criterion, the product performance of public accounting in Lethbridge appears to be good. The Chartered Accountant firms provided the highest quality of service and there is range in the quality of services provided by the other public accountants. Thus, overall the product performance of public accounting in Lethbridge seems to be satisfactory.

#### PROGRESSIVENESS

Production techniques in any sector of the economy are continually or intermittently improving, with the general result of lowering the real costs of producing various goods and services. The development and introduction of improved production techniques generally involves two distinguishable stages. The first is the invention or discovery of the new techniques, which thus becomes available for use. The second is the innovation or actual application of the new and available techniques. The concern with this dimension of an industry's market performance is whether or not it is adequately or ideally progressive in developing and applying new techniques, and thus con-

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<sup>4</sup>. Ibid., p. 424-425.



tributing to the increased productivity of the economy. The criterion for evaluating the "progressiveness" performance of an industry is to establish the degree to which it has "exploited the available opportunities for invention and innovation."<sup>5</sup> But the measurement of the "what might have been" against the "what happened" would be extremely complex and perhaps inconclusive; therefore some economists feel the progressiveness can not be operationally defined, and thus should receive little attention in appraising an industry's performance.<sup>6</sup> Yet, Bain defines the ideal performance for the innovation aspect of this dimension to be:

"an ideal rate of innovation through time in an industry is one that promptly exploits every available technological change that would reduce costs of producing the goods or services in question (the costs of the innovations taken into account)."<sup>7</sup>

Since there has been a number of recent opportunities for innovation in public accounting; a general measurement of the "progressiveness" performance of public accounting in Lethbridge can be obtained.

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<sup>5</sup>. Ibid., p. 419.

<sup>6</sup>. Stern and Grabner, Competition in the Marketplace, p. 64.

<sup>7</sup>. Bain, op. cit., p. 420.



The first opportunity for innovation which will be examined is the use of computers in the preparation of client's records and statements. The proof that this is a more productive and cost saving innovation is apparent from the extensive application of the computer for this purpose in other areas of the province and country. Although the large capital outlay necessary for even a small computer may have made this innovation uneconomical to most some time in the past, the opportunity to now have access to a computer on a "time-sharing" basis where the public accountant need only pay for the computer time actually used makes this an economical innovation. Question 21 of the questionnaire asked the firms if they made use of a computer in the preparation of client's records and statements. Of the five Chartered Accountant firms, four firms answered "yes" and one firm answered "no". All other public accountants answered "no". The second opportunity for innovation was the adoption of the new auditing techniques of flow charting and statistical sampling. Since, virtually all auditing in the area is done by Chartered Accountants this innovation is applicable only to them. In follow-up interviews the firms were







questioned about their auditing procedures. All firms mentioned that they used flow charts and statistical sampling to some extent at least. However, question 26 of the questionnaire asked these same firms the method they used to verify the computer output when auditing a business firm which used a computer in its accounting system. All firms answered that they "audit around the computer by manual test-checks of records".<sup>8</sup> This is an out-moded and inefficient method of auditing the output of a computer. A number of more efficient methods have been adopted: one of which is to use a pre-set deck of data cards to check the computer's operation. Yet overall the "progressiveness" performance of Chartered Accountants in Lethbridge appears satisfactory; whereas again the performance of other public accountant firms seems poor.

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<sup>8</sup>. See question 71 of the questionnaire.



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## APPENDIX I

## PART A

For All to Complete

Were you engaged in public accounting in Alberta in 1970, either as a sole practitioner, partner, or as a full or part-time employee of a firm?

Yes \_\_\_\_\_  
No \_\_\_\_\_

Note: If NO do Not answer the remaining questions, please return this questionnaire.

## I. SOCIO-ECONOMIC BACKGROUND

1. What is your sex? (check one)

Male \_\_\_\_\_  
Female \_\_\_\_\_

2. In which age group are you?

29 or younger .....  
30 to 39 .....  
40 to 49 .....  
50 to 59 .....  
60 to 69 .....  
70 or over .....

3. Where were you born:

in Canada .....  
in the U.K. ....  
in the U.S.A. ....  
Other (specify) .....

If you were born in Canada, in which province were you born?

4. Newfoundland _____	Manitoba _____
Nova Scotia _____	Saskatchewan _____
New Brunswick _____	Alberta _____
Prince Edward Island _____	B. C. _____
Quebec _____	Yukon or _____
Ontario _____	N.W.T. _____

5. Your father's occupation was:

a Public Accountant _____	another Profession _____
Manager _____	Owner of a business _____
White-collar worker _____	Blue-collar worker _____
Farmer _____	Other _____



6. Did you have any sort of financial subsidization, either through public or private sources (not family), during any of your post-secondary schooling?

Yes, for the entire time period \_\_\_\_\_  
 Yes, through half or more of the time \_\_\_\_\_  
 Yes, for less than half of the time \_\_\_\_\_  
 No \_\_\_\_\_

7. How important was family financial support during your post-secondary schooling?

Very important \_\_\_\_\_  
 Fairly important \_\_\_\_\_  
 Minor importance \_\_\_\_\_  
 Of no importance \_\_\_\_\_

8. In choosing your profession, one or more factors may have influenced you. How important an influence for you was:

A feeling that the work done by accountants is important and interesting?  
 a very important influence \_\_\_\_\_  
 a fairly important influence \_\_\_\_\_  
 a minor influence \_\_\_\_\_  
 No influence at all \_\_\_\_\_

In choosing your profession, one or more factors may have influenced you. How important an influence for you was:

9. The availability of financial subsidization for schooling?

a very important influence \_\_\_\_\_  
 a fairly important influence \_\_\_\_\_  
 a minor influence \_\_\_\_\_  
 No influence at all \_\_\_\_\_

10. Having a relative in this profession?

a very important influence \_\_\_\_\_  
 a fairly important influence \_\_\_\_\_  
 a minor influence \_\_\_\_\_  
 No influence at all \_\_\_\_\_

11. Having a friend who entered this profession?

a very important influence \_\_\_\_\_  
 a fairly important influence \_\_\_\_\_  
 a minor influence \_\_\_\_\_  
 No influence at all \_\_\_\_\_





12. The expectation of an adequate income?

- a very important influence \_\_\_\_\_
- a fairly important influence \_\_\_\_\_
- a minor influence \_\_\_\_\_
- No influence at all \_\_\_\_\_

## II. FORMAL EDUCATION

13. What was the extent of your secondary education?

- no secondary education \_\_\_\_\_
- left before completing high school; my program included some bookkeeping \_\_\_\_\_
- left before completing high school; no bookkeeping in my program \_\_\_\_\_
- completed high school; my program included some bookkeeping \_\_\_\_\_
- completed high school; no bookkeeping in my program \_\_\_\_\_

14. What was the extent of your university education?

- no university education \_\_\_\_\_
- attended without obtaining a degree \_\_\_\_\_
- obtained a bachelor's degree \_\_\_\_\_
- obtained a master's degree \_\_\_\_\_
- obtained a doctorate degree \_\_\_\_\_

15. If you graduated with a degree from a university, what was the main core of your undergraduate program?

- Bachelor of Commerce with an accounting major \_\_\_\_\_
- Bachelor of Commerce \_\_\_\_\_
- Law \_\_\_\_\_
- Arts \_\_\_\_\_
- Engineering \_\_\_\_\_
- Science \_\_\_\_\_
- Other; please specify \_\_\_\_\_

16. If you have graduated with a postgraduate degree, what was the main core of your postgraduate course?

- Accounting \_\_\_\_\_
- Economics \_\_\_\_\_
- Business Administration \_\_\_\_\_
- Law \_\_\_\_\_
- Arts \_\_\_\_\_
- Engineering \_\_\_\_\_
- Science \_\_\_\_\_
- Other, please specify \_\_\_\_\_



## III. PROFESSIONAL BACKGROUND

17. Of what accounting bodies are you a member?

I am a member of:

Institute of Chartered Accountants  
of Alberta (and Canadian Institute  
of Chartered Accountants). \_\_\_\_\_

Certified General Accounts Assoc.  
of Alberta (and its national  
organization) \_\_\_\_\_

Accredited Public Accountants of  
Alberta (and its national  
organization) \_\_\_\_\_

Society of Industrial and Cost  
Accountants of Alberta (and its  
national organization) \_\_\_\_\_

Other (specify)

- (4) a. \_\_\_\_\_  
b. \_\_\_\_\_  
c. \_\_\_\_\_

No organized accounting body \_\_\_\_\_

18. What was the MAIN way in which you gained your practical experience in accounting, prior to becoming a public accountant?

- I had no prior practical experience \_\_\_\_\_
- in the office of a public accountant \_\_\_\_\_
- in the employment of the government \_\_\_\_\_
- in the employment of a business firm \_\_\_\_\_
- other (specify) \_\_\_\_\_

19. In what year did you complete your formal accounting training?

(19\_\_\_\_)

20.

To the nearest birthday, how old were you when you sat for the first of your accountancy examinations? (check one)

under 16 years	_____	28 to 30 years	_____
16 to 18 years	_____	31 to 35 years	_____
19 to 21 years	_____	36 to 40 years	_____
22 to 24 years	_____	41 to 45 years	_____
25 to 27 years	_____	46 years and over	_____



21. From when you actively commenced taking courses in accountancy subjects, how many years elapsed before you completed all the examinations necessary to obtain membership in a professional body of accountants? Exclude war service years where studies were interrupted. (check one)

3 or less	_____	8 years	_____
4 years	_____	9 years	_____
5 years	_____	10 years	_____
6 years	_____	11 years	_____
7 years	_____	12 or more	_____

22. For how many years, in total, have you been engaged in public accounting work of any type? (check one)

Less than 5 years	_____	25 to 28 years	_____
5 to 8 years	_____	29 to 32 years	_____
9 to 12 years	_____	33 to 36 years	_____
13 to 16 years	_____	37 to 40 years	_____
17 to 20 years	_____	41 years and over	_____
21 to 24 years	_____		

23. What is your position in your firm?

Individual practitioner	_____
Partner of a firm	_____
Manager of an office (but not a partner)	_____
Staff accountant	_____

24. Is your firm -

National or international firm (offices in more than 4 provinces)	_____
Regional firm (offices in 4 or fewer provinces)	_____
Provincial firm (more than 1 office in Alberta)	_____
Local (only 1 office)	_____

25. Approximately, what is the total number of full-time staff employed by your firm throughout Alberta (including partners, owners and clerical or other employees)? (check one)

one	_____	5 - 9	_____	50 - 99	_____
Two	_____	10 -14	_____	100 -199	_____
Three	_____	15 -29	_____	200 and more	_____
Four	_____	30 -49	_____		







26. What is the size of the office in which you are employed, i.e. in terms of the number of all full-time employees including owners? If your firm maintains more than one office, please confine your answer to the office with which you are primarily associated. (check one)

1 - 3	_____	13 - 18	_____	37 - 42	_____
4 - 6	_____	19 - 24	_____	43 - 49	_____
7 - 9	_____	25 - 30	_____	50 - 60	_____
10 - 12	_____	31 - 36	_____	60 or more	_____

27. Where is your office located?

- Edmonton \_\_\_\_\_
- Calgary \_\_\_\_\_
- Lethbridge \_\_\_\_\_
- Medicine Hat \_\_\_\_\_
- Red Deer \_\_\_\_\_
- Other (specify) \_\_\_\_\_

28. Please estimate the total number of hours you work during an average week?

	<u>Jan 1-Apr. 30</u>	<u>May 1-Dec. 30</u>
- less than 20 hours	_____	_____
- 21 to 30 hours	_____	_____
- 31 to 35 hours	_____	_____
- 36 to 40 hours	_____	_____
- 41 to 45 hours	_____	_____
- 46 to 50 hours	_____	_____
- 51 to 55 hours	_____	_____
- 56 to 60 hours	_____	_____
- over 60 hours per week (specify)	_____	_____

29. What types of practising accounting work did you personally perform during the past year, and approximately what percentage of your public accounting time did you spend on each? (Your best estimates are sufficient. Please ensure that your percentages total 100 per cent.)

	Percentage
Administration of a public accounting office, personnel work, and recruiting (non-chargeable)	_____
Supervision and review of the work of others performed mainly at your office (chargeable)	_____
Supervision of audit clerks, etc. performed at clients' places of business	_____
Audit work (excluding supervision and report writing) performed mainly at clients' places of business	_____



## Percentage

Preparation of income tax returns and other income tax work \_\_\_\_\_  
 Estate work including preparation of estate and gift tax returns \_\_\_\_\_  
 Liquidations, receiverships, and bankruptcies \_\_\_\_\_  
 Bookkeeping and write-up work including preparation of financial statements \_\_\_\_\_  
 System design and installation work \_\_\_\_\_  
 Financial management advice \_\_\_\_\_  
 Other management advisory services \_\_\_\_\_  
 Special investigations (re new share issues, etc.) \_\_\_\_\_  
 Other public accounting work not specified above \_\_\_\_\_

30. During the last three years of your practice what has been the average length of your vacation. (If practising for less than three years, then answer for the shorter period).

- 2 weeks or less \_\_\_\_\_  
 - 3 weeks \_\_\_\_\_  
 - 4 weeks \_\_\_\_\_  
 - 5 or 6 weeks \_\_\_\_\_  
 - over 6 weeks \_\_\_\_\_

31. How satisfied are you with amount of time you must devote to your job?

- too much time must be devoted \_\_\_\_\_  
 - satisfied with time spent \_\_\_\_\_  
 - insufficient time devoted \_\_\_\_\_

32. On an average, how many hours per week (not necessarily of your working time) do you devote free of charge to working for council and committee work, charitable institutions, chambers of commerce, public authorities, churches, boy scouts, and similar public organizations?  
 (check one)

Less than

One	_____	Four	_____	Seven	_____
Two	_____	Five	_____	Eight	_____
Three	_____	Six	_____	Nine or more	_____

33. What is the total number of days in the last three years that you have spent participating in development or technical programmes conducted either in-house or by recognized accountancy bodies? (e.g. conventions, seminars, lectures, study groups, etc.) (check one)

None	_____	1 - 5 days	_____
5 - 10 days	_____	10-15 days	_____
15 - 20 days	_____	Over 20 (specify)	_____





34. What is the extent of your reading of these two journals?

Canadian Chartered Accountant

Do not read it as I do not receive it \_\_\_\_\_  
 Receive it but never look at it \_\_\_\_\_  
 Occasionally read an article \_\_\_\_\_  
 Regularly read one or more articles \_\_\_\_\_  
 Usually read almost all of every issue \_\_\_\_\_

Cost and Management

35. Do not read it as I do not receive it \_\_\_\_\_  
 Receive it but never look at it \_\_\_\_\_  
 Occasionally read an article \_\_\_\_\_  
 Regularly read one or more articles \_\_\_\_\_  
 Usually read almost all of every issue \_\_\_\_\_

36. Do you read any other professional accountancy journals? (check one)

Never \_\_\_\_\_  
 Occasionally read an article \_\_\_\_\_  
 Regularly read one or more articles \_\_\_\_\_  
 Do a fair amount of reading \_\_\_\_\_

37. If you read any other journals, please specify the journal you read most often:

\_\_\_\_\_

38. What was your personal annual income from practising accounting work (only) for the past year - before deducting income tax?  
 (If you are a partner, please include your share of profits, interest, salary allowance, or bonus. If you are an employee, include any bonus. In all cases please exclude income from sources other than from your work as an accountant in public practice - e.g. company directorships.)  
 (check one)

Less than \$5000	_____	\$10,000 to \$10,999	_____
\$5000 to \$5999	_____	\$11,000 to \$12,999	_____
\$6000 to \$6,999	_____	\$13,000 to \$14,999	_____
\$7000 to \$7,799	_____	\$15,000 to \$17,499	_____
\$8000 to \$8,999	_____	\$17,500 to \$19,999	_____
\$9000 to \$9,999	_____	\$20,999 to \$24,999	_____
		\$25,000 to \$29,999	_____
		\$30,000 to \$39,999	_____

continued





\$40,000 to \$49,999 \_\_\_\_\_  
 \$50,000 to \$74,999 \_\_\_\_\_  
 \$75,000 to \$99,999 \_\_\_\_\_  
 More than \$100,000 \_\_\_\_\_

29. How satisfied are you; generally, with the income you currently receive from your professional practice?

- income too high \_\_\_\_\_
- satisfied with present income level \_\_\_\_\_
- income too low \_\_\_\_\_

40. If you have any sources of income other than your professional practice, please indicate the average annual amount and the general nature of the source: (e.g. real estate investments, etc.)

<u>Amount per year</u>	<u>Source</u>
\$ _____	_____
\$ _____	_____



PART B

## For Persons in Charge of an Office

(This part is to be completed by only one person from each office - i.e. by the partner or individual practitioner or manager in charge. It is to be completed with data relative to that office only).

1. Does your Firm hold itself out to the public as a firm of: (check one)

Chartered Accountants \_\_\_\_\_

Certified General Accountants \_\_\_\_\_

Registered Industrial Accountants \_\_\_\_\_

Accredited Public Accountants \_\_\_\_\_

Other Association (Specify) \_\_\_\_\_

Independent \_\_\_\_\_

2. How long has your office been operating in the same community (not necessarily at the same address)? The fact that the present owners are not the same as the original owners does not necessarily mean that the continuity of the office has been affected. If in doubt, please approximate (check one).

Under 1 year \_\_\_\_\_

20 - 29 years \_\_\_\_\_

1 year \_\_\_\_\_

30 - 39 years \_\_\_\_\_

2 - 4 years \_\_\_\_\_

40 - 49 years \_\_\_\_\_

5 - 9 years \_\_\_\_\_

50 years or  
more \_\_\_\_\_

10 - 19 years \_\_\_\_\_

3. How many people are there employed in your office in each of the following categories?

- (a) Owners or Partners? (check one)

None \_\_\_\_\_

Four \_\_\_\_\_

Eight \_\_\_\_\_

One \_\_\_\_\_

Five \_\_\_\_\_

Nine or  
more \_\_\_\_\_

Two \_\_\_\_\_

Six \_\_\_\_\_

Three \_\_\_\_\_

Seven \_\_\_\_\_



(b) Managers or Supervisors? (other than partners)  
(check one)

None	_____	Four	_____	Eight	_____
One	_____	Five	_____	Nine or	_____
Two	_____	Six	_____	more	_____
Three	_____	Seven	_____		

(c) Full-Time Staff Accountants (check one)

None	_____	Four	_____	20 - 24	_____
One	_____	5 - 9	_____	25 or	_____
Two	_____	10 -14	_____	more	_____
Three	_____	15 -19	_____		

## (d) Full-Time Students enrolled in each of the following courses? (Indicate Number)

C.A. course	_____
R.I.A. course	_____
C.G.A. course	_____

(e) None	_____	Four	_____	20 - 24	_____
One	_____	5 - 9	_____	25 or	_____
Two	_____	10 -14	_____	more	_____
Three	_____	15 -19	_____		

(f) Part-Time (e.g. during busy months or less than 21 hours per week) (check one)

None	_____	Four	_____	Eight	_____
One	_____	Five	_____	Nine or	_____
Two	_____	Six	_____	more	_____
Three	_____	Seven	_____		

## 4. How many of the full-time accounting staff of your office have completed all requirements for professional certification as

Chartered Accountants (C.A.)	_____
Registered Industrial Accountants (R.I.A.)	_____
C.A. and R.I.A.	_____
Certified General Accountants	_____
Accredited Public Accountants	_____
Other (specify)	_____





5. What was the total amount of gross fees received by your office for 1965 and 1970? (if your office did not exist in 1965 please complete the 1970 column)

	<u>1965</u>	<u>1970</u>
Under \$5,000	_____	_____
\$10,000-\$19,999	_____	_____
\$20,000-\$29,999	_____	_____
\$30,000-\$49,999	_____	_____
\$50,000-\$99,999	_____	_____
\$100,000-\$199,999	_____	_____
\$200,000-\$499,999	_____	_____
\$500,000-\$1,000,000	_____	_____
\$1,000,000-\$1,500,000	_____	_____
\$1,500,000-\$2,000,000	_____	_____
Over \$2,000,000	_____	_____

6. Please indicate the Percentage of gross fees derived by your office from each of the following areas of service during 1965 and 1970 (if your office did not exist in 1965 please complete the 1970 column only).

	<u>1965</u> Percentage	<u>1970</u> Percentage
Auditing	_____	_____
Taxes	_____	_____
Management Services	_____	_____
Preparation of client's records and statements	_____	_____
Other public accounting work	_____	_____
TOTAL	<u>100%</u>	<u>100%</u>

7. Please indicate the Percentage of total time of your office spent providing the following areas of service during 1965 and 1970 (if your office did not exist in 1965, please complete the 1970 column only).

	<u>1965</u> Percentage	<u>1970</u> Percentage
Auditing	_____	_____
Taxes	_____	_____
Management Services	_____	_____



	1965 Percentage	1970 Percentage
Preparation of client's records & statements	_____	_____
Other public accounting work	_____	_____
TOTAL	<u>100%</u>	<u>100%</u>

8. In what types of activities are your clients engaged? Please indicate the approximate percentage of gross fees received from clients in each of the following business-activity classes during the last year. (A rough guess is better than no answer). (Your percentages should total 100 per cent).

	Percentage
Agriculture, forestry, fisheries	_____
Mining, oil exploration	_____
Construction, manufacturing	_____
Transportation, communication, public utilities	_____
Wholesale and retail trade including cafes)	_____
Services (professional and business) hotels, entertainment	_____
Non-profit organizations, government and semi-government, religious, charitable, welfare, private persons	_____
Finance, insurance, real estate	_____

9. What proportion of the gross fees of your office in 1970 was received from clients in each of the following size categories? (This could be a difficult question to answer, but a rough approximation will be better than no answer). (Your percentages should total 100 per cent).



	Percentage
Less than 10 employees	_____
10 - 99 employees	_____
100 - 499 employees	_____
500 employees or more	_____
TOTAL	<u>100%</u>

10. Approximately, what was the total number of clients for whom your office undertook work and booked chargeable time in the last year?

The total number was \_\_\_\_\_

11. What is the basis of setting fees charged by your office? The two main bases are, (1) an amount per hour or per day for the services of an individual irrespective of the nature of the task, and (2) a fee based on "what the job is worth", which takes into account, in addition to time spent, the complexity of the task, and/or the client's ability to pay, and/or the benefit to the client, and/or other factors.

- (a) Thinking only in terms of these two bases, what portion of your fees for the past year was charged on a "time spent" basis and what portion on the "what the job is worth" basis?  
(check one)

Almost all fees set on "time spent" basis (0) \_\_\_\_\_

Approximately 75%-95% on "time spent" basis; rest on "what the job is worth" basis (1) \_\_\_\_\_

Approximately 55%-74% on "time spent" basis; rest on "what the job is worth" basis (2) \_\_\_\_\_

Roughly half on each basis (3) \_\_\_\_\_

Approximately 25%-45% on "time spent" basis; rest on "what the job is worth" basis (4) \_\_\_\_\_

Approximately 5%-24% on "time spent" basis; rest on "what the job is worth" basis (5) \_\_\_\_\_

Almost all fees set on "what the job is worth" basis (6) \_\_\_\_\_





- (b) When the "time spent" basis is used what is the most important consideration in setting your fee? (check one)

Your view of what competitors would be likely to charge (0) \_\_\_\_\_

Your view of what the client would be willing to pay for the work done (1) \_\_\_\_\_

Providing the partners with some reasonable level of income if things go as planned (2) \_\_\_\_\_

Information on billing rates provided by:

Institute of Chartered Accounts (3) \_\_\_\_\_

Accredited Public Accountants Association (4) \_\_\_\_\_

Head Office of your firm (5) \_\_\_\_\_

- (c) When the "what the job is worth" basis is used what is the most important consideration in setting your fee? (check one)

Your view of what competitors would be likely to charge \_\_\_\_\_

Your view of what the client would be willing to pay for the work done \_\_\_\_\_

Providing the partners with some reasonable level of income if things go as planned \_\_\_\_\_

12. When charges are made on a "time spent" basis, what does your office charge per hour for the services of the following types of personnel? (i.e. where you employ these) What was the average rate charged per hour during the past year?

(a) \$75.00	_____	\$25-\$29.99	_____
\$50-\$75.00	_____	\$20-\$24.99	_____
\$40-\$49.99	_____	\$15-\$19.99	_____
\$30-\$39.99	_____	\$10-\$15.00	_____
		Under \$10.00	_____



## (b) For Supervisors and Managers? (other than partners)

\$50.00 and more	_____	\$20-\$24.99	_____
\$40-\$50.00	_____	\$15-\$19.99	_____
\$30-\$39.99	_____	\$12.50-\$14.99	_____
\$25-\$29.99	_____	\$10-\$12.49	_____
		Under \$10.00	_____

## (c) For Staff Accountants?

\$30.00	_____	\$12.50-\$14.99	_____
\$25-\$29.99	_____	\$10-\$12.49	_____
\$20-\$24.99	_____	\$12.50-\$9.99	_____
\$15-\$19.99	_____	\$5.00-\$9.49	_____
		Under \$5.00	_____

## (d) For Students?

\$20.00 or more	_____	\$7.50-\$10.00	_____
\$15-\$20.00	_____	\$5-\$7.49	_____
\$12.50-\$14.99	_____	Under \$5.00	_____
\$10-\$12.49	_____		

## (e) For Calculating-Machine Operators, Typists, etc.?

\$20.00 or more	_____	\$7.50-\$9.99	_____
\$15-\$20.00	_____	\$5-\$7.49	_____
\$12.50-\$14.99	_____	\$2.50-\$4.99	_____
\$10-\$12.49	_____	Under \$2.50	_____

13. Of what importance is the "ability to pay" of a client in determining the final bill presented?

a large role	_____
a small role	_____
has no effect	_____

14. If all other public practitioners in your area were to keep their fee rates at those prevailing today and your firm was to increase its rates by 25%, which of the following is likely to occur? (check one)

The firm would lose a large number of its clients	_____
The firm would lose some of its clients	_____
There would be no or very little loss of clients	_____



15. If all other public practitioners in your area were to keep their fee rates at those prevailing today and your firm was to decrease its rates by 25%, which of the following is most likely to occur? (check one)

The firm would gain a significant number of clients \_\_\_\_\_

The firm would gain some clients \_\_\_\_\_

There would be no or very little gain of clients \_\_\_\_\_

16. If your firm changed its fee rates, do you believe other firms in your area would adjust their rates accordingly? (check one)

Yes \_\_\_\_\_

Probably \_\_\_\_\_

Very doubtful \_\_\_\_\_

No \_\_\_\_\_

17. If the major firm in your area was to change its fee rates, would your firm adjust its rates accordingly? (check one)

Yes \_\_\_\_\_

Probably \_\_\_\_\_

Very doubtful \_\_\_\_\_

No \_\_\_\_\_

18. In your opinion, what is the main reason that clients are attracted to your firm rather than other firms in your area?

Quality of service \_\_\_\_\_

Competitive fee structure \_\_\_\_\_

Promotional Activities  
(e.g. social contacts,  
newsletters, announce-  
ments, etc.) \_\_\_\_\_

Specialization in certain  
types of accounting  
services \_\_\_\_\_





19. There are a number of ethical means of establishing and improving client relationships (e.g. luncheons, club memberships, newsletters, etc.) Approximately how much is spent by your office on these activities annually - (check one)

less than \$250	_____	\$1,000-\$2,499	_____
\$250-\$499	_____	\$2,500-\$5,000	_____
\$500-\$999	_____	Over \$5,000	_____
		Specify	_____

20. If your office audits a firm that uses a computer in its accounting system which of the following methods do you use to verify the computer's output?

Audit around the computer, by manual test-checks of records \_\_\_\_\_

Check the computer's operation with a pre-set deck of data cards \_\_\_\_\_

Other (specify) \_\_\_\_\_

21. If your office provides write-up services for any of your clients, do you make use of a computer in the preparation of clients' records and statements?

Yes \_\_\_\_\_

No \_\_\_\_\_

22. Normally the period from January 1 to April 30 is the "busy season" for public accountants and during the period from May 1 to December 31 the demand for services is not as great. If this situation applies to your office, what percentage of the total monthly working hours of all full-time staff would you consider are not being utilized effectively during the period from May 1 to December 31?

less than 5 per cent	_____
5 to 9.9 per cent	_____
10 to 14.9 per cent	_____
15 to 19.9 per cent	_____
20 to 25 per cent	_____
over 25 per cent	_____
(specify)	_____



23. Does your office provide your staff with any internal formalized staff training and/or development programs? (e.g. Formal lectures, courses, group discussion, etc.) (check one)

No	_____	Monthly	_____
Occasionally	_____	Twice monthly	_____
Quarterly	_____	Weekly	_____

24. If your office does provide some internal formalized staff training: Who attends? (check one)

New staff only	_____	Both new and older staff	_____
Older staff only	_____		

25. Who gives the instruction MAINLY? (check one)

Member(s) of staff e.g. partners	_____	Representatives of accounting equipment firms	_____
Outside profes- sional teachers	_____	Others	_____

26. What is the teaching approach MAINLY? (check one)

Lectures	_____	Material published by accounting equip- ment firms	_____
Case Problems	_____		
Text-book(s)	_____	Other	_____
Journal articles and official recommenda- tions	_____		

27. Approximately, what was the average percentage of annual gross fees spent by your office on training and development activities over the past three years (including salaries of all staff in attendance, paying for outside courses, etc.)



less than 1 per cent	_____
1 to 2.9 per cent	_____
3 to 4.9 per cent	_____
5 to 7.4 per cent	_____
7.5 to 9.9 per cent	_____
10 to 15 per cent	_____
over 15 per cent (specify)	_____

28. Taking salary costs in consideration, which of the following would you prefer to hire as a student accountant or trainee?

- high school graduate \_\_\_\_\_
- Bachelor degree graduate (other than Commerce) \_\_\_\_\_
- Commerce graduate - without an accounting major \_\_\_\_\_
- Master of Business Administration graduate \_\_\_\_\_
- Master of Business Administration - an accounting major \_\_\_\_\_

29. Referring to the above question, approximately what would be the average starting salary which your firm would be willing to pay this preferred person (assuming this person has no practical accounting experience).

\$ \_\_\_\_\_/month

30. If you have students or trainees in your office, what percentage of the average salary of the newly qualified graduate accountant (i.e. the newly qualified graduate's salary equals 100%) is the average salary of the following students?

Newly qualified graduate accountant	<u>100%</u>
4th year student	_____
3rd year student	_____
2nd year student	_____











**B30016**